ANNUAL REPORT 2006

INNOVATIONS FOR TOMORROW'S DRUGS

Developing
Pharmaceutical
Success....

4SC

INNOVATIONS FOR TOMORROW'S DRUGS

Contents

The company

Management Report

Financial Statements (IFRS)

Milestones 2006

New project in the pipeline
In the second quarter 4SC AG announced a partnership with the Institute for Molecular Virology at the University of Münster. A substance from the NFκB project that had proven highly efficacious against influenza viruses in preclinical trials is now to be further developed in an independent project.

US patent granted for clinical project
Around midyear the US Patent and Trademark Office granted 4SC AG a patent on the chemical composition of a group of DHODH inhibitors. The substances are chemically related to 4SC AG's clinical most advanced drug candidate, SC12267. This increases the attractiveness of the project for potential pharmaceutical industry licensers.

Milestone in collaborative business
In the second half of the year 4SC AG had already obtained its objectives for the diabetes cooperation with Sanwa Kagaku Kenkyusho within an unexpectedly short period of time, receiving a substantial milestone payment. 4SC AG's integrated technology platform once again allowed the company to prove its added value as a cooperation partner.

Start of clinical phase IIa for SC12267
After several months of preparatory groundwork, in December 4SC AG received official regulatory approval required to commence an international, multicentre clinical phase IIa study for its substance in the most advanced stage of development, SC12267, for the treatment of rheumatoid arthritis.

Licensing agreement signed with QuoNova
At the end of the year 4SC AG signed a major deal with QuoNova LLC concerning the global development and marketing of QSB substances identified by 4SC AG and the associated know-how. The deal gives 4SC AG a 10% stake in the venture established by the US XL TechGroup.

Development of important key figures

in KEUR	2006	2005	2004	2003	2002
Net sales	3,664	2,068	3,023	1,017	554
Result from operating activities	- 5,530	- 6,337	- 5,458	- 9,182	- 8,085
Period result	- 5,540	- 6,277	- 5,821	- 9,508	- 8,338
Earnings per share (EUR)[1]	- 0.50	- 0.77	- 0.89	- 1.78	- 2.10
Shares in circulation (annual average; in thousands)	11,125	8,188	6,574	5,337	3,979
Equity	7,854	9,159	- 49	4,495	5,899
Equity ratio	78.8%	81.5%	- 0.7%	49.6%	52.5%
Balance sheet total	9,973	11,244	6,730	9,066	11,229
Cash flows from operating and investing activities	- 8,476	- 5,833	- 4,474	- 7,827	- 9,831
Cash flows from financing activities	4,120	10,653	3,352	7,396	7,188
Net change in cash and cash equivalents	- 4,356	4,820	- 1,122	- 431	- 2,643
Cash and cash equivalents	2,522	6,878	2,058	3,180	3,611
Number of employees (incl. Management Board; annual average)	55	52	61	72	70

1: Data for 2002 and 2003 has been made comparable and is therefore not in accordance with data published in the respective financial statements.

General information

Security code number 575381
ISIN DE0005753818
SE code VSC

Management Board
Dr Ulrich Dauer, CEO
Dr Gerhard Keilhauer, CDO
Dipl.-Kfm. Enno Spillner, CFO
Dr Daniel Vitt, CSO

Principal Office
4SC AG
Am Klopferspitz 19a
82152 Planegg-Martinsried
Germany

IR Contact
Bettina von Klitzing
E-Mail: Bettina.von.Klitzing@4SC.com
Phone 0049 (0) 89 700 763-0
www.4SC.com

Dear shareholders,

With our first financial year as publicly traded company now behind us, I would like to take the opportunity to discuss our achievements in 2006, our current position and our plans for the future.

As a research-oriented drug discovery and development company we have not yet obtained profitability, as is to be expected, yet our net loss for 2006 was less than the year prior. Sales revenues were up a solid 77% to nearly 3.7 million Euros. With revenues in the collaborative business stable, the signing of a licensing deal with QuoNova in connection with our QSB project had a major impact – validating our business strategy of pursuing licensing partnerships for proprietary projects with an eye primarily towards medium-term objectives.

The licensing deal for our QSB substances, useful against bacterial biofilms, was signed shortly before year-end, coming as a surprise to some as a relatively low profile project. The project originated from research and development activities prior to our strategic decision to focus on inflammatory disease and cancer therapies. However, its success illustrates the strength and versatility of our integrated technology platform and therapeutic projects based upon it. Aside from revenues from the transaction, the 10% equity stake acquired in QuoNova, an American company, holds great promise. The largest shareholder in the company, the American XL TechGroup, is strongly convinced of the marketing potential of QSB substances, bringing the necessary experience to the table. It has a track record of building up a number of similar innovative firms which it has taken public within a few short years. Our equity investment thus could yield significant value for 4SC AG over the medium term.

Pipeline progress

As announced, in 2006 we primarily concentrated on advancing our pipeline projects. After extensive efforts laying the necessary groundwork, at the end of the year we received regulatory approval and a positive ethics vote from Friedrich-Alexander-University for the start of clinical phase IIa study on our drug candidate SC12267. This study, being conducted on patients with rheumatoid arthritis (RA) at 13 centres throughout Germany, Poland and Serbia, is designed to test the therapeutic efficacy and safety of SC12267 and determine proper dosages for further developmental purposes. If the results, likely forthcoming in the fourth quarter of 2007, are in line with expectations, this should substantially enhance its attractiveness as a drug candidate for prospective pharmaceutical partners.

We also made progress with our other pipeline projects. Two new potential candidates were nominated for clinical development from our three preclinical projects underway: SC68896 from the proteasome project and SC71570 from the NFκB project. The strikingly high activity of the substance SC68896 with multiple myeloma convinced us to proceed with preparation for clinical development. We recently nominated SC71570 as a development substance for autoimmune and inflammatory diseases. This NFκB inhibitor had previously demonstrated a strong impact on immune cells and proven more effective in animal trials for rheumatoid arthritis than the competitor product Methotrexate on the market, currently seen as the "gold standard" for basic RA therapy. Production process and suitable formulations are currently being worked out for these two development candidates for mandatory safety testing prior to initial use in human. If things proceed according to schedule, we should be able to apply for approval for clinical trials for both projects before the end of 2007.
We have already reported in detail on another success story connected with our NFκB project during the course of the year: having demonstrated in collaboration with the University of Münster that a number of the NFκB inhibitors we developed inhibit the multiplication of influenza viruses, including the highly pathogenic H5N1 strain.
During the reporting year we also performed successful data gathering on the activity of substances in tumour models within the 4iP project, in collaboration with the company ProQinase based in Freiburg. A substance that attacks cancer from multiple sides caused existing tumours to shrink in mice.
4SC AG is actively pursuing six projects, resulting from its own discovery pipeline. Each project addresses an area of high medical need offering enormous market potential. This makes 4SC AG of interest to the pharmaceutical industry as a partner in need of licensing partnerships for completing their product pipelines.

Milestones in the collaborative business

We also had a number of successes to report in the collaborative business in 2006. In October we were able to announce the successful conclusion of our joint diabetes research project with the Japanese company Sanwa Kagaku Kenkyusho. Having achieved the objectives in an unexpectedly short period of time, 4SC AG will be participating in the future success of this diabetes project through potential milestone payments and royalties.

We likewise reached another key milestone in our joint project with Schwarz Pharma underway since 2003, although strategic realignment at Schwarz Pharma led to discontinuing of urology R&D activities. The project rights were transferred to 4SC AG in return for a share of potential licensing income. Our objective now is to license out the project to a suitable partner specialising in this field of medical treatment.

Maximising opportunities and diversifying risk

In 2007 our efforts will be primarily directed towards the advancement of our six proprietary pipeline projects. Our expectation is for several drug candidates to achieve key short and medium-term development milestones, thereby enhancing project and enterprise value.

In addition we intend to move a number of new projects into the discovery pipeline in the near future that offer growth potential and risk diversification for the project portfolio. 4SC AG's research activities have shown that individual development candidates provide a type of platform upon which various projects may be built for a range of indications.

Management Board of 4SC AG (from left to right):
Dr Ulrich Dauer, Dr Gerhard Keilhauer, Dr Daniel Vitt, Dipl.-Kfm. Enno Spillner

This is the case in particular with our clinical development substance SC12267, currently in phase IIa study on rheumatoid arthritis patients, which just a few weeks ago was granted an US patent. This opens up opportunities for testing the substance with other disorders such as atopical dermatitis and psoriasis and chronic inflammatory bowel diseases.

Clinical development would be feasible in these areas at relatively moderate expense given our experience with SC12267. Development for chronic inflammatory bowel diseases would be directly comparable with development of the rheumatoid arthritis drug. Also, the time until proof of clinical activity would probably be greatly shortened for either topical or oral forms of application for the aforementioned skin treatments. Shortened development times would of course abbreviate the over-all discovery process leading up to market launch.

We are currently looking at individual preclinical development options with the goal of laying the groundwork for starting formal development this year given an adequate base of positive data. Despite requiring additional financing, the expense would remain manageable. Having considered the matter in depth, we believe the additional growth potential is such that we should not pass up this opportunity.

I would thus like to sincerely thank our shareholders for the trust they have placed in 4SC AG. Investing in biotech companies is known to be a long-term proposition, yet we are confident of our ability to increase the value of our enterprise substantially in the foreseeable future. In particular I would also like to thank our employees for their dedication and tireless commitment to the success of our organisation.

Dr Ulrich Dauer
Chief Executive Officer

4SC at the stock exchange

The year 2006 offered a positive stock market environment on the whole – reasons are a stable global economy and a sustained upturn in Germany. Euroland economies prospered in 2006. The DAX rose by 22% for the year, while the benchmark Prime IG Biotechnology Performance index developed positively as well and ended the year up nearly 19%.

4SC shares followed the market trend until mid-year, starting off the trading year 2006 at 4.40 Euros versus the initial listing price of 4.41 Euros on 15 December 2005. The shares traded sideways in the first quarter before a substantial rise starting in March. An announcement concerning research on an agent effective against the influenza virus triggered a rally up to a record high of 5.45 Euros on 13 April 2006. By the middle of the second quarter however the shares were unable to resist overall market selling pressures, declining despite positive news on another joint research project with Solvay and approval of an US patent for our clinical rheumatoid arthritis project. After release of the Q2 results the shares recovered moderately in August and September before taking a downswing in October. On 10 November 2006 4SC shares reached a record low of 3.21 Euros. Regulatory approval for starting clinical phase IIa trials for the rheumatoid arthritis project gave the shares a brief boost that again ended in lateral movement. 4SC shares ended the year at 3.69 Euros on 31 December 2006, for a market capitalisation of 42.3 million Euros.

May capital increase

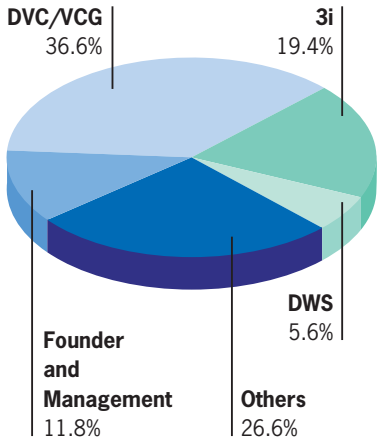
The 11 May 2006 capital increase increased company share capital to roughly 11.5 million Euros with the issuance of 931,288 shares without shareholder subscription rights. The shares went primarily to institutional investors interested in increasing holdings in 4SC shares following the 15 December 2005 listing in volumes difficult to achieve in the secondary market. The stock offering generated 4.3 million Euros in gross proceeds for the company.

Increase in free float

Shares issued as of 31 December 2006 numbered 11,461,365, nearly 12% of which were held by the management and founders of 4SC AG. Reportable shareholdings in excess of 5% of subscribed capital were held by the 3i Group Investment LP (approximate 19%), DVCG (Deutsche Venture Capital Gesellschaft mbH & Co. Fonds II KG) and VCG (Venture Capital Gesellschaft mbH & Co. Fonds III KG) holding a combined approximate 37% and DWS Investment GmbH with an approximate 6% stake. Free float using the Deutsche Börse calculation rules came to 23%, an approximate 8% increase versus the previous year. Average daily trading volume was 6,898 (Xetra).

SHAREHOLDERS' STRUCTURE

Share property in percent
(as of 2006-12-15)



THE SHARE

Security code number	575381
ISIN	DE0005753818
SE code	VSC
Class	Bearer shares
Total shares issued	11,461,365
Segment	Prime Standard
Stock Exchange	Xetra and all German exchanges
Designated	Close Brothers Seydler AG
Sponsors	VEM Aktienbank AG
1st trading day	15 December 2005

1 According to these rules, shareholdings of a cumulative 5% or more of share capital per share type by a single shareholder constitute non-free floating closely held/control stock.

SHARE PRICE

In April 2006 shares reached a record high of 5.45 Euros. The record low of 3,21 Euros was reached in November.

Close Brothers Seydler AG and VEM Aktienbank were designated sponsors of 4SC AG. Since going public, two analysts, Dr Stefan Schröder of SES Research and Thomas Schießle for Midas Research have initiated coverage of 4SC shares, publishing regular update reports. Their outlook for the company remained positive through year-end 2006, rating the 4SC shares 'buy'.

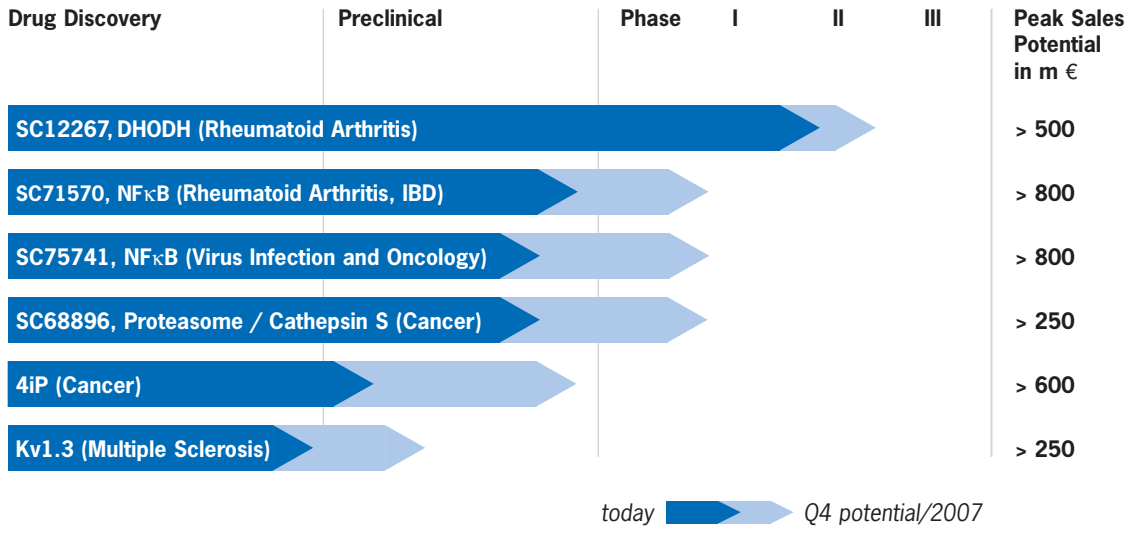
Ongoing dialogue with the financial market

In addition to the reporting requirements associated with Prime Standard listing, company management insists on timely, comprehensive and reliable communication with all financial market participants. The Management Board and Investor Relations Manager maintain an ongoing dialogue with institutional and private investors, analysts, the media and the general public. 4SC AG posts relevant information on the company website in the interest of prompt communications with all parties. 4SC AG also makes use of other communication channels such as e-mail news, teleconferences, interviews, trade show presentations and shareholder forums. Regular road shows keep both existing and prospective investors informed about business developments at 4SC AG and the outlook for the company.

IR CONTACT
IR Manager: Bettina von Klitzing
Phone 0049 (0) 89 700 763 - 0
E-Mail: Bettina.von.Klitzing@4SC.com

4SC PIPELINE

Six projects are already in different stages of development; each bar represents the current study phase. Behind them is the sales potential of a corresponding drug according to projections by 4SC AG.



Innovations for tomorrow's drugs

Drug candidates for blockbuster markets

The biotech sector is the primary driver of growth and innovation in the pharmaceutical industry, for which keeping product pipelines full is an increasing problem. But nearly no other German biotech company is focusing as consequently on this part as 4SC AG. The company specialises first of all as a generator of new and innovative drug candidates through in-house research and development. 4SC AG plans the involvement of licensing partners early on in the process, after successful proof of concept in the clinical phase IIa study in which evidence of drug safety and efficacy is documented. This relatively early involvement strategy allows 4SC AG to pursue multiple projects simultaneously, more effectively diversifying the risks inherent with drug development.

4SC AG projects focus exclusively on 'blockbuster' markets exhibiting high medical need and outstanding sales potential of special inter-est to the pharmaceutical industry. In building up its pharmacological expertise the company has focused on the development of drug candidates for the treatment of inflammatory diseases and cancer – both of extreme importance from both a medical and business standpoint. The two fields share a single cause of disease – misregulated cell growth – while additionally being characterised by manageable clinical study expenses until proof of concept.

Continuous supply of new ideas

4SC AG's technological platform enables the company to steadily generate new project candidates for further research and development independently of any outside parties. The platform allows computer-aided (therefore accelerated) identification of potential drug candidates, uniting the entire spectrum of R&D competencies ranging from medicinal chemistry and cellular biology to preclinical and clinical expertise. This can shorten the development time from target identification to the start of clinical development by as much as two and a half years. The recent licensing and sale of the Quorum Sensing Blockers developed by 4SC AG for inhibiting bacterial biofilms illustrates the numerous opportunities this platform affords outside of the company's therapeutical focus. Prominent pharmaceutical partners like Schwarz Pharma and the Japanese company Sanwa Kagaku Kenkyusho among many others are indicative of 4SC's advanced expertise, with whom the company has conducted sales-generating joint R&D projects using its integrated technology platform.

The core of the 4SC AG business model consists of six proprietary research and development pipeline projects. These projects demonstrate the innovative strength of the organisation, representing the true value and growth potential of the firm which is why in the following the projects are presented in greater detail.

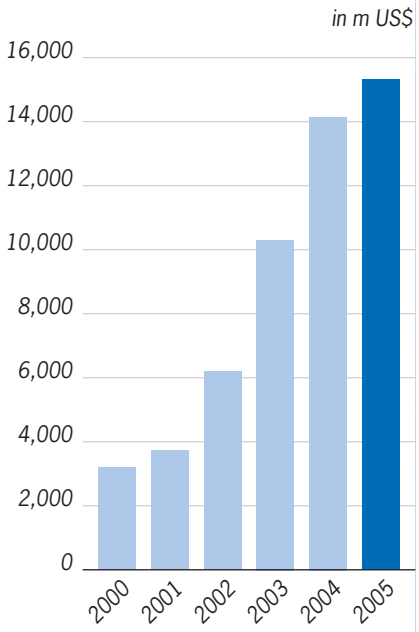
4SC AG projects exclusively address markets evidencing high medical need and sales potential. Herein lies the growth potential of the company.

Lead project in phase IIa

SC12267	
Indication	Rheumatoid Arthritis
State	Phase IIa
Peak Sales Potential	> 500 m €
Market entry	possible in 2011

Sales of drugs against rheumatoid arthritis are rising exponentially*.

Source: MedTRACK



SC12267 focuses on the treatment of rheumatoid arthritis (RA), a disease involving painful inflammation of the joints, potentially leading to their severe degeneration. Approximately one percent of the world's population is afflicted with RA, thus demand for pharmaceutical treatment is correspondingly high. Existing treatment options are inadequate, which include chemical therapeutic agents like Methotrexate and Leflunomide, better known as the Arava® drug by Aventis, alongside regular pain medication. Positive results are offset by significant gastrointestinal side effects, leading over a quarter of patients to abandon treatment within a short time. There are also therapeutic proteins known as biologicals, such as the drug Humira® by Abbott, that are able to slow progression of the disease; yet these can only be injected and are typically ten times as expensive than small molecular, oral medications.

SC12267 functions similarly to Arava® on the identical target already clinically validated, which greatly increases its prospects of success. The active agent of 4SC AG however exhibits a far more favourable side-effect profile, opening up potential for use in combination with established therapies as well as on its own. The agent has been in the clinical phase IIa since December 2006 following two successful phase I studies on healthy subjects. In this international and multicentre study, 120 patients with active RA will be treated for three months with SC12267. The results of this study are expected to be released in the fourth quarter of 2007.

The next step for SC12267 is a licensing partnership with a pharmaceutical company to accelerate further developmental efforts. A corresponding drug could be launched potentially by the year 2011. As the RA treatment market represents some 6-7 billion Euros annually, the sales potential of SC12267 alone is estimated at over an annual 500 million Euros. Furthermore, the active agent could in principle also be employed for other autoimmune diseases such as multiple sclerosis, inflammatory bowel disease and skin afflictions such as psoriasis.

*Total of sales of HUMIRA (Abbott Laboratories), ENBREL (Amgen Inc, Wyeth), KINERET (Amgen Inc), ORENCIA (Bristol-Myers Squibb Company), SUVENYL (Chugai Pharmaceutical Co Ltd), REMICADE (Johnson & Johnson), NEORAL/SANDIMMUN (Novartis AG), VOLTAREN (Novartis AG), CELEBREX (Pfizer Inc), MABTHERA/ RITUXAN (Roche Holdings Ltd), REMICADE (Schering-Plough Corp), ARAVA (Sanofi-Aventis), PLAQUENIL (Sanofi-Aventis)

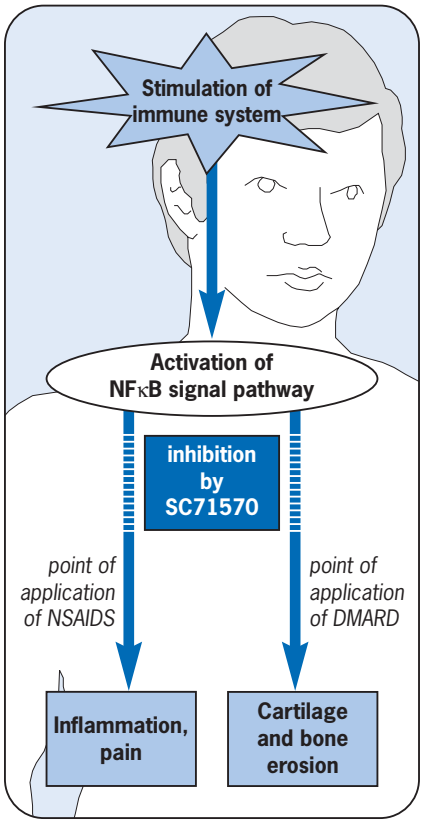
New therapeutic approach against inflammation

SC71570	
Indication	Rheumatoid Arthritis, IBD
State	Preclinical
Peak Sales Potential	> 800 m €
Market entry	possible in 2013

Drug candidate SC71570 is also for the treatment of rheumatoid arthritis (RA), but represents a quite different therapeutic approach. In addition it is designed for treating chronic inflammatory bowel disorders such as Crohn's disease and Ulcerative Colitis. Roughly 4 million people worldwide suffer from these yet untreatable maladies, particularly widespread in industrialised Western countries, involving a range of different symptoms including abdominal pain, intestinal bleeding and skin irritations. Current treatment options are limited mostly to cancer therapy drugs, cortisone and surgical intervention.

SC71570 is part of an entirely new class of active agents identified by 4SC AG that block the NFκB signal pathway, a key mechanism in inflammatory processes. These NFκB inhibitors are able to regulate the activation of the body's immune cells. SC71570 proved extraordinarily efficacious in a preclinical RA animal study; even more so than the leading drug Methotrexate in basic RA treatment. 4SC AG nominated SC71570 as a development substance in January 2007, so all relevant data on the safety of the active agent will be gathered and documented over the next few months before proceeding to file for clinical trial approval.

The agent could thus potentially lead to an entirely new oral medication on the market by 2013 for the treatment of chronic illnesses such as rheumatoid arthritis and inflammatory bowel disease. Revenue potential is estimated at around 800 million Euros annually, with additional potential for use in the treatment of cancer, chronic respiratory illnesses and viral infections.



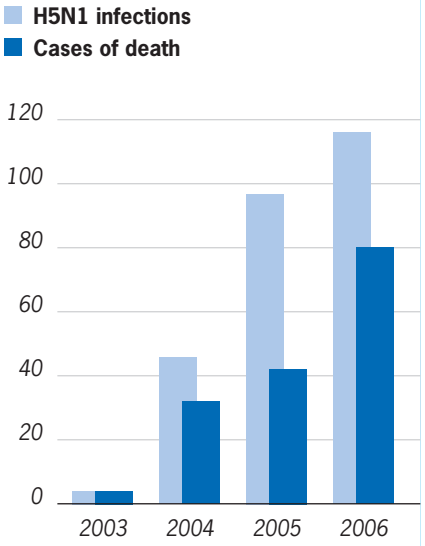
SC71570 belongs to a new class of substances that block the NFκB signal pathway.
Source: 4SC AG

Twofold active principle against viral infections

SC75741	
Indication	Virus Infection and Oncology
State	Preclinical
Peak Sales Potential	> 800 m €
Market entry	possible in 2015

Thus far only a few people worldwide have been affected by the 'bird flu', but for most of these it proved fatal. Treatment options are limited.

Source: Robert Koch Institute



The drug candidate SC75741 is designed for the treatment of viral infections, particularly Hepatitis C and acute influenza, representing tremendous medical need. For infants and the elderly, even the ordinary annual flu epidemic can be life-threatening. Thus far a few hundred people worldwide have been affected by the highly pathogenic H5N1 avian virus known popularly as the 'bird flu'. A pandemic scenario would even involve numbers in the millions. Also, some 150-200 million people worldwide suffer from Hepatitis C, which in chronic form leads to liver cancer.

Existing flu medications such as Tamiflu® by Roche only minimally shorten the length of treatment, and resistant virus mutations have already formed. These drugs are only efficacious against avian influenza if taken within 48 hours. The situation is similarly dissatisfactory with Hepatitis C, where the conventional treatment with Interferon alpha and Ribavirin only helps in 50% of cases while entailing powerful side effects.

SC75741 opens up totally new possibilities in this field. As an NFκB inhibitor, the substance works in two ways. On the one hand it impedes multiplication of the virus, thus preventing the infection of new cells, while also suppressing the often deadly overreaction of patients' immune systems. Acquired resistance to this agent is highly improbable due to this particular mechanism.

For this project, 4SC AG has partnered with Prof. Stefan Ludwig of the Institute for Molecular Virology at the University of Münster, one of the leading researchers in the field of influenza viruses. Preclinical studies for the agent SC75741 are currently underway.

A drug with an enormous potential of over 800 million Euros in sales volume could be on the market by 2015. This figure does not factor in potential application of the substance in the treatment of Alzheimer's or Parkinson's disease. For stroke therapy initial positive animal trial data is already available.

Proteasome inhibitor against cancer

SC68896	
Indication	Cancer
State	Preclinical
Peak Sales Potential	> 250 m €
Market entry	possible in 2013

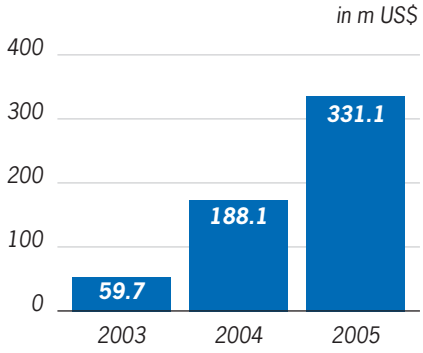
The proteasome inhibitor SC68896 is a drug candidate for the treatment of cancers including multiple myeloma. The overproduction of antibodies associated with this deadly form of cancer suppresses normal blood cell formation. This results in debility and dizziness, progressive bone degeneration and improper kidney functioning. The survival period varies by treatment option between three and five years. Some 74,000 people are affected worldwide, with only inadequate treatments available involving conventional chemotherapy, only capable of extending the lifespan by a few years at best.

SC68896 blocks the proteasome enzyme, thereby causing specifically fast-growing cancer cells to die off. The agent is thus designed for the same clinically validated target as the first-ever approved proteasome inhibitor Velcade® by Millenium. The high toxicity of Velcade® however involves significant side effects in the treatment. Unlike Velcade®, the inhibitor developed by 4SC AG is not chemically reactive and therefore has a substantially lower risk of side effects. SC68896 has proved efficacious in preclinical animal trials and bone marrow biopsies. Regulatory preclinical studies will get underway in the second quarter of 2007 to determine and document safety of usage. Filing for approval for clinical study phase I is planned for the second half of the year.

A drug based on this substance could go on the market starting from 2013. The sales potential for a multiple myeloma medication is estimated at around 250 million Euros per year. However, this agent has additional potential as indicated by experimental animal trial data, for example for the treatment of brain and other solid tumours. The peak sales estimate advanced by Millenium and Johnson & Johnson for Velcade® of over one billion US Dollars should likewise be obtainable for SC68896 should it succeed.

"SC68896 *in vitro* is significantly more potent than conventional cytostatics and is our most promising candidate in preclinical multiple myeloma research."

DR RALF SCHMIDMAIER,
UNIVERSITY OF MUNICH HOSPITAL



Sales of Velcade® (Millenium), another proteasome inhibitor for multiple myeloma, have more than quintupled in two years.

Source: MedTRACK

New kinase inhibitors against cancer

4iP

Indication	Cancer
State	Preclinical
Peak Sales Potential	> 600 m €
Market entry	possible in 2014

Medical progress is still limited when it comes to the treatment of cancer, which remains a deadly disease entailing drastic loss of quality of life. However, cancer medications alone still generate some 40 billion US Dollars in sales, a figure projected to rise further.

Many tumour therapies employ cytostatic drugs which attack rapidly growing cancer cells, but also affect healthy cells, causing the familiar side effects. But also more focused therapies such as the use of antibodies have proven only partially effective for treatment. Inhibitors of kinases, which are responsible for the uncontrolled growth of cancer cells, are currently seen as highly promising. These types of medications, such as Glivec® by Novartis, have been among the recent global blockbusters, generating several billion US Dollars in sales.

The 4iP programme of 4SC AG, developed in collaboration with ProQinase GmbH, a specialist in the field, likewise focuses on the suppression of kinases, adopting a multiple target approach in which multiple kinases are attacked simultaneously. 4iP active agents simultaneously suppress the proliferation (cell division) and formation of metastases, while also inhibiting angiogenesis (blood vessel formation by means of which cancer cells obtain nourishment).

4SC AG and ProQinase have synthesised and characterised several thousand substances, paving the way for the development of a host of medications. The drug candidate in the most advanced phase is currently in preclinical development and has already proven efficacious in multiple animal trials.

A first drug based on 4iP substances could go on the market starting from 2014. These substances clearly have blockbuster potential, meaning potential annual sales in excess of one billion US Dollars. In view of strong demand for innovative tumour therapies, 4SC AG estimates peak sales potential of over 600 million Euros. Kinases are also a factor in other illnesses such as autoimmune disorders. Potential synergies with other 4SC AG projects are possible.

The pharmaceutical industry has offered in the hundreds of millions for cancer drug candidates.

Source: MedTRACK

Date	*Deal size*	*Source*	*Partner*
08/2006	*500 m US$*	*Infinity Pharmaceuticals, Inc. (Global)*	*MedImmune Inc (US Public)*
07/2006	*200 m US$*	*Santaris Pharma A/S (Global)*	*Enzon Pharmaceuticals Inc (US Public)*
03/2006	*400 m US$*	*Infinity Pharmaceuticals, Inc. (Global)*	*Novartis AG (US Public)*
12/2005	*520 m US$*	*Astex Therapeutics Limited (Global)*	*Novartis AG (US Public)*
11/2004	*530 m US$*	*Medarex Inc (US Public)*	*Bristol-Myers Squibb Company (US Public)*
06/2004	*384 m US$*	*Vertex Pharmaceuticals Inc (US Public)*	*Merck & Co Inc (US Public)*
04/2004	*291 m US$*	*Roche Holdings Ltd (US Public)*	*ArQule Inc (US Public)*

Ion channel blocker for new MS-therapy

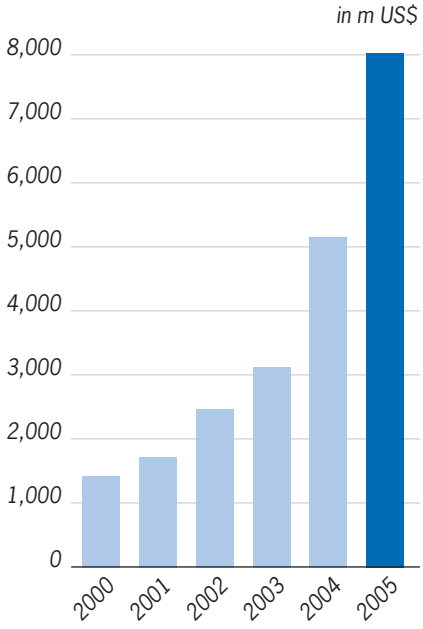
Kv1.3	
Indication	Multiple Sclerosis
State	Discovery
Peak Sales Potential	> 250 m €
Market entry	possible in 2016

The latest project of 4SC AG is utilising the inhibition of the ion channel blocker Kv1.3 for the treatment of multiple sclerosis (MS). This disease causes progressive nerve cell degeneration of the patient and paralysis, starting with the extremities.

Roughly 650,000 people suffer from MS in Europe and the US alone, with 10,000 new cases developing each year. There is to this day still no cure for MS, and only a limited number of symptomatic treatment options. The therapeutic principles applied thus far are based on immunomodulation via ß interferons (e.g. Betaseron® by Schering), which are tissue hormones found in the body that are effective against viral infection. This approach is not effective with all patients however, and can have considerable side effects. Upon ceasing the medication, patients suffer a worsening condition in the form of a rebound effect. Costs generated by MS annually in the US alone run to approximately 2.5 billion US Dollars.

Multiple sclerosis results from the improper regulation of T cells, normally responsible for the immune defence system, which begin destroying nerve cells. The new drug candidate of 4SC AG is designed to selectively block these unregulated T cells, suppressing them without completely destroying the body's normal immune response, as is the case with existing MS therapies. The project Kv1.3 is still in the research phase, and is partially funded by the Federal Ministry of Education and Research (BMBF) in connection with the BioChancePlus competition. The next step is the identification of an optimised lead compound for preclinical development.

A MS drug could be ready to go to market by 2016, generating an estimated minimum of 250 million Euros in sales. Improperly regulated T cells also play a role in such widespread disorders as asthma, arthritis and neurodermatitis. The market potential for an effective agent for these applications would likewise be vast.

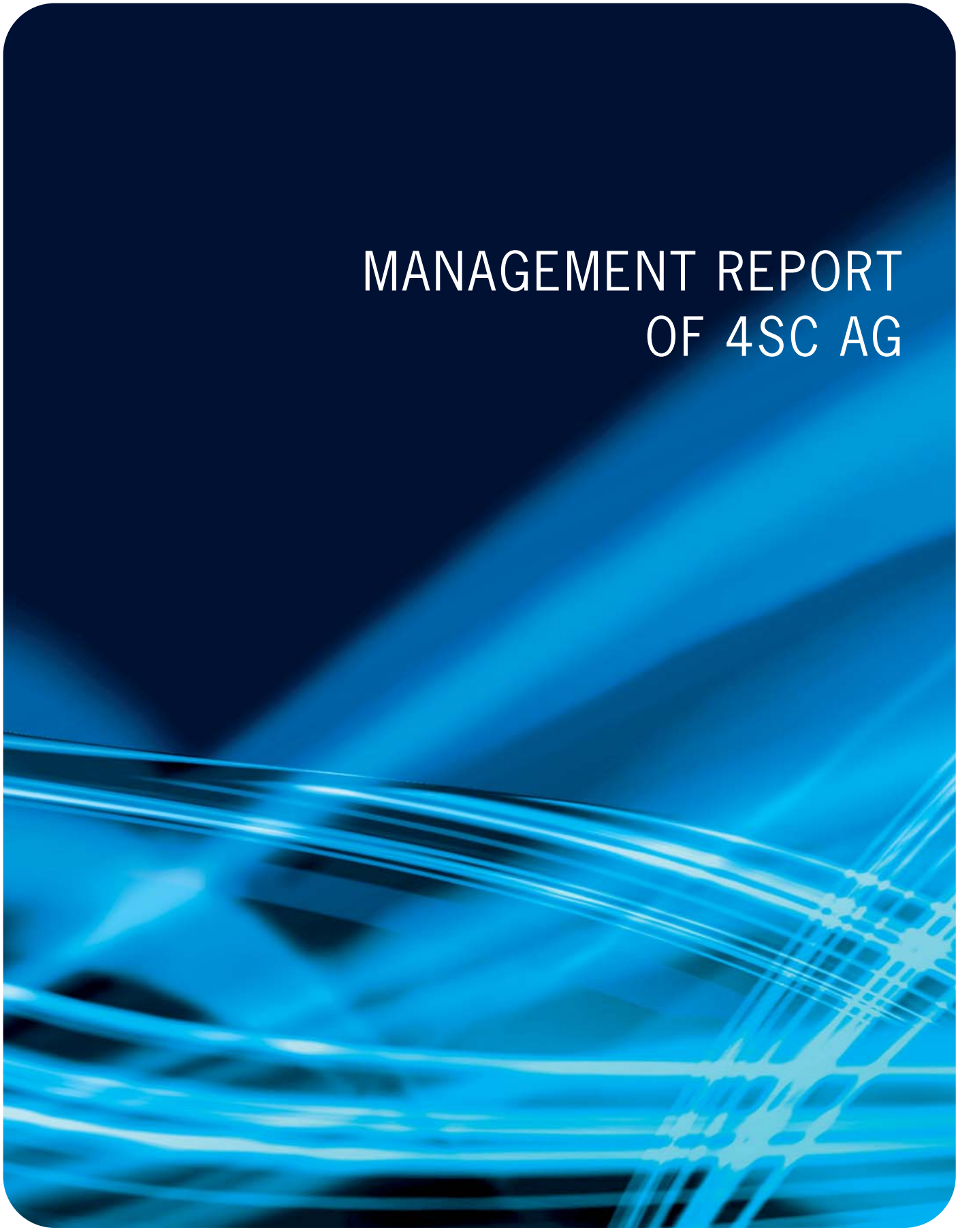


Sales of medications for multiple sclerosis have nearly tripled within three years even though their efficacy remains limited*.

Source : MedTRACK

*Total of sales of AVONEX (Biogen Idec Inc), TYSABRI (Biogen Idec Inc, ELAN Corp Plc), BETASERON (Novartis AG), HP ACTHAR GEL (Questcor Pharmaceuticals Inc), BETAFERON/BETASERON (Bayer-Schering AG), COPAXONE (Sanofi-Aventis), NOVANTRONE (Merck Serono S.A), REBIF (Merck Serono S.A), COPAXONE (Teva Pharmaceutical Industries Ltd)

MANAGEMENT REPORT OF 4SC AG



1. Presentation of the course of business

1.1 Development of overall economy

1.1.1 Economic development

The global economy remained on track for growth in financial year 2006, despite a letup in the pace for some national economies towards the end of the year. The interim quite noticeable rise in consumer prices due to volatile energy prices has recently lost some of its momentum. The German Central Bank for example believes inflationary pressures may have abated somewhat over the last few months, presumably in response to moderate interest moves by central banks in 2006.

The International Monetary Fund (IMF) has estimated global gross domestic product (GDP) growth for 2006 at 5.1%. Emerging markets came out well above this average at around 7.3%, whereas the US and Eurozone posting 3.4% and 2.4% growth respectively are squarely below the average.

According to the latest reports released by Germany's Federal Statistical Office, Germany economic output in 2006 was up significantly by 2.7% (GDP), counter to expectations. This was mainly due to sharply rising exports, an upturn in construction, pre-VAT hike consumption and one-time effects including the Football World Cup.

1.1.2 Development of stock exchange segments

With global economies prospering, stock market indices were up despite sharp corrections during the second quarter, showing in part substantial year-end price gains.

All major indices ended the year higher, the S&P 500 up 13.3%, the Nikkei 225 up 5.7% and the DAX up 21.9%. For biotechnology relevant stock indices also developed generally well in 2006, the NASDAQ Biotechnology Index closing +0.4%, the Amex Biotechnology Index +10.8% and the Prime IG Biotechnology Performance Index +18.8% for the year.

1.2 Developments in the biotechnology industry

The pharmaceutical and biotechnology sectors are among the most future-oriented fields in global business. Biotechnology has taken on increasing importance, being increasingly recognised as the growth engine in this field. This is reflected on the one hand by an increasing number of development candidates in various clinical phases of development and approval. According to a DZ Bank study, for example, between roughly 40% of all newly approved drugs originate from biotechnology firms. Another factor is a significantly greater amount of financing available to biotechnology companies worldwide from both public markets and venture capital. However, the vast majority of funds are invested in North America, while many biotechnology firms remain chronically underfinanced, particularly in Europe.

Negative news and setbacks also appear. Risks inherent to the industry frequently manifest themselves in the form of aborted clinical studies and denied regulatory approvals, with consequences for shareholder value and industry partnerships.

The lack of productivity increases in the pharmaceuticals industry has been due to such challenges including a partially tightening regulatory environment, cost pressures by the different healthcare systems, increasing competition from generic manufacturers with concurrently expiring patents and an increasingly evident lack of innovative follow-on products. The latter circumstance in particular is allowing biotechnology firms to partner up and do business with pharmaceuticals players at earlier stages of drug development and at increasing attractive conditions. Outright buyouts by drug companies and large biotech firms have been seen with increasing frequency.

The biotechnology sector in Europe and Germany did its part in contributing to a positive mood with several announcements of favourable study results, drug approvals, new partnerships and financial data. However, both private and public sector investors, key to nurturing biotech growth, were selective, resulting in fewer but generally larger transactions with biotech firms. A series of large European-level mergers and acquisitions such as Bayer/Schering, UCB/Schwarz Pharma, Astra Zeneca/CAT and Merck KG a.A./Serono has brought significant dynamism into once stagnating structures, as anticipated. A few German companies like Geneart and Wilex have also been emboldened enough to go public.

Biotechnology in Germany appears to be flourishing on the whole, gradually developing the critical mass to become established as an independent business sector.

1.3 Business and general conditions

4SC AG has become specialised in research and development for the discovery of new drugs for the treatment of chronic inflammatory diseases and cancer, creating a sustainable pipeline of proprietary therapeutic projects which it typically develops up to the clinical proof of concept stage. The objective is to realise the commercial potential of these projects through licensing agreements with players in the pharmaceuticals industry. Licensing revenues, milestone payments and royalties form the cornerstone for long-term growth of the enterprise in the primary focus of the "Drug Discovery & Development" segment. 4SC AG's therapeutic focus centres on cancer and inflammatory diseases since these indications combine significant market potential and high medical needs with reasonable development time and cost in the early clinical stages.

In financial year 2006 the "Drug Discovery & Development" segment focused on the further advancement and diversification of the proprietary project pipeline. This was reflected by progress made on current projects such as the NFκB project for the treatment of autoimmune diseases such as rheumatoid arthritis (SC71570) and 4SC's proteasome inhibitors for the treatment of cancer (SC68896), which are being systematically taken up to the clinical development stage. In parallel, new and innovative projects are being initiated, such as involving NFκB inhibitors for the treatment of viral infections. Preparations for and launch of the clinical phase IIa study for the DHODH project (SC12267) was at the top of the agenda.

In the "Collaborative Business" segment 4SC AG has concluded deals making its technology platform available to external pharmaceutical and biotechnology partners as part of service packages, generating net sales contributing to 4SC's bottom line.

1.4 Development of sales and orders

Net sales totalled KEUR 3,664 for the reporting year, up by KEUR 1,596 or 77.2% year on year (2005: KEUR 2,068). Of this total, KEUR 1,683 or roughly half of the net sales were generated by the "Drug Discovery & Development" segment, which brought in an additional KEUR 1,551 versus the previous year (2005: KEUR - 132). This substantial increase was driven mainly by revenues from the successful licensing of exclusive global rights to QSB substances to QuoNova LLC., Melbourne, Florida, USA.

Net sales for the "Collaborative Business" segment were up slightly to KEUR 1,981, a 2.3% increase (2005: KEUR 1,936). 4SC AG was able to successfully conclude its diabetes research partnership originally signed in 2005 with Sanwa Kagaku Kenkyusho Co. Ltd., Nagoya, Japan, in an unexpectedly short period of time, receiving substantial payments. A key milestone was also reached in the joint project with Schwarz Pharma AG, Monheim, likewise resulting in payments to 4SC AG. These two collaborations together account for 90% of net sales; options are currently being evaluated for pursuing new applications with both partners within future collaborative efforts.

1.5 Procurement

4SC AG's procurement, logistics and warehousing processes are standardised and defined and are organised and handled by a central purchasing department. Particular emphasis is placed upon a high degree of integration for purchasing processes down to the individual workstation level. Close coordination between Purchasing and Accounting ensures smooth processes from order inquiry down to payment of invoices.
In the interest of maintaining both autonomy and flexibility, 4SC AG is careful to avoid dependence on individual suppliers, who are selected according to strict pricing, availability and quality criteria. More favourable delivery terms were again negotiated in financial year

Preparations for and launch of the clinical phase IIa study for the DHODH project (SC12267) was at the top of the agenda in 2006.

2006, in parallel to 4SC AG's considerable involvement in the Biotech Region Munich purchasing association in an effort to further optimise delivery terms.

1.6 Investment and fixed assets

In financial year 2002 4SC AG invested considerably in fixed assets, a move from which the company continues to benefit. For the reporting year, replacement and initial purchases of fixed and intangible assets totalled KEUR 377 (2005: KEUR 109), primarily representing investment in technical lab equipment (KEUR 110), IT hardware (KEUR 110) and miscellaneous business equipment (KEUR 53). The company also invested KEUR 71 in acquisition of a patent. With investment levels remaining moderate, the book value of fixed and intangible assets declined from KEUR 3,354 for the year prior to KEUR 3,105 for the reporting year. Depreciation of fixed and intangible assets amounted to KEUR 625 for the reporting year (2005: KEUR 819).

4SC AG continues to hold an equity interest of 48.8% in quattro research GmbH, Planegg-Martinsried, as a financial asset. Additionally, a 10.0% stake was acquired in the start-up QuoNova LLC., Melbourne, Florida, USA in late December 2006, also held as a financial asset. Cash raised in the framework of the December 2005 stock exchange listing was invested in the reporting year in fixed and variable interest securities of high-rated issuers valued at KEUR 1,949 (2005: KEUR 0).

1.7 Goodwill

As in previous years, capitalised goodwill from the merger of 4SC GmbH into 4SC AG in the year 2000 was recognised as an asset on the balance sheet at a value of KEUR 1,786 (2005: KEUR 1,786), measured according to IFRS 3 since financial year 2005. In accordance with IFRS 3.55 and IAS 36.90, no scheduled depreciation is performed, but instead a goodwill impairment test is performed at least once annually. The impairment test conducted at the end of the financial year did not indicate a need for adjustment of the 31 December 2006 value.

1.8 Financing measures

The only financing measure conducted during the reporting year was on 11 May 2006 a stock offering versus cash without subscription rights, which serves to strengthen the company's financial position. The offering, priced at EUR 4.65 per share, was placed predominantly with institutional investors. This transaction increased the company's share capital by KEUR 931 from KEUR 10,530 at the start of the financial year to KEUR 11,461 at year-end. The issue generated gross cash proceeds of KEUR 4,330 for 4SC AG.

The level of cash and cash equivalents held fell from KEUR 6,878 to KEUR 2,522 as of year-end due to negative cash flows from operating and investing activities of KEUR - 8,476 (2005: KEUR - 5,833).

1.9 Personnel and social security

4SC AG maintained an average 55 employees (incl. Management Board) during financial year 2006. This represents a slight year-on-year increase, having added three employees to the previous year's average of 52. Personnel costs rose moderately versus the year prior to KEUR 3,693 (2005: KEUR 3,569). Coming after significant declines in average staffing levels in the years 2004 and 2005 (down nine employees), 4SC's staffing structure has now solidified into a firm foundation for future growth.

As in previous years, 4SC AG again succeeded in consolidating its position as the technology leader in computer-aided drug discovery and development.

40 of the 55 employees (incl. four Management Board members) were in Research and Development, nine in Administration and two employees in Information Technology. The company created a new position in the Drug Supply area and filled to key positions in both Business Development and Pharmacology & Preclinical Development that became vacant in 2005.
A number of new positions are to be created and filled in the course of 2007 as the company continues to move ahead with its projects. Because highly motivated employees are at the core of our organisation in future as well, 4SC AG authorised two new employee stock option programmes in the reporting year. The "ESOP 2006" and "ERSATZ-ESOP 2001" tranches adopted by shareholders at the 28 June 2006 shareholders' meeting were issued to employees in August 2006. "ESOP 2006" involves entirely new terms designed around current market conditions. The "ERSATZ-ESOP 2001" was offered to long-term company employees formerly enrolled in the expired "ESOP 2001". As the terms of the latter tranche rendered it largely ineffective as an incentive, the attractive substitute programme was offered as an alternative, replacing the previous options. The company has offered stock options since 2001, viewing them as an integral part of its corporate culture and a valuable employee retention instrument.

1.10 Occupational safety and environmental protection

During the past financial year, 4SC AG again took all necessary measures to avoid or minimise environmental pollution. 4SC AG has appointed two Bio/Chemical Safety Officers and a Safety Head to oversee the company's internal and external affairs in these areas in collaboration with an external occupational safety specialist (from Gesellschaft für Laborsicherheit, Karlsfeld). There were no reportable safety-related events known to the company during the reporting year.
All chemicals are documented in a hazmat registry in accordance with applicable hazmat regulations, and all lab personnel are trained in the handling of hazardous materials to ensure maximum workplace safety and minimise environmental impact. 4SC AG implements its waste disposal concept with the aid of the company Wittmann in Gräfelfing, thereby ensuring compliance with quantitative requirements and regulations in the interest of protecting our environment.
Inventories of hazardous materials and the use thereof are kept as low as possible to save on resources and reduce laboratory hazards. The company inspected all of its safety-related systems and equipment in 2006 in compliance with regulations and overhauled them where necessary. In addition, the requested risk evaluation was created and the resulting measures were implemented pursuant to priorisation.
Permits are on file for the security level 1 and 2 laboratories and the radionuclide lab maintained, which are subject to constant regulatory oversight. A Radiation Safety Officer and two deputies were appointed to ensure the safe operation of the radionuclide lab. There were no events during the reporting year necessitating special reporting or intervention by regulators. Operation of the animal trial lab is subject to monitoring by an external animal protection officer who advises 4SC AG on animal experimentation and protection issues. All animal experimentation conducted has without exception been conducted as part of officially approved trials.

1.11. Research and Development

1.11.1 Technology

As in previous years, in financial year 2006 4SC AG again succeeded in consolidating its position as the technology leader in computer-aided drug discovery and development. Two newly developed procedures represent the innovative impulse allowing 4SC AG to computer model the interaction of molecules on specific, individual targets. This method has evidenced impressive predictive value as documented by several scientific publications in the reporting year.

Establishment of a department for pharmaceutical formulation and production has expanded 4SC AG's technological developmental capabilities. This allows 4SC AG to provide tailored formulations of active molecules for the desired application (oral, dermal or inhalatory) while still in the research phase. This not only accelerates the R&D process considerably, it also results in a qualitative improvement.
The company contracted with certain external providers in specific developmental areas

during the reporting year, primarily as mandated by regulations and in cases where 4SC AG preferred to utilise its own capacity for other purposes for greater efficiency.

1.11.2 Project pipeline

Research activities during the reporting year centred on the further clinical development of drug candidate SC12267. Having laid the necessary regulatory groundwork, in December 2006 4SC AG launched its clinical phase IIa rheumatoid arthritis study. Preclinical development projects also saw successes in 2006, leading to the nomination of two new development candidates, SC68896 and SC71570. In addition, new study results showed that substances from the NFκB project exhibit high levels of antiviral activity effective against influenza viruses.

SC12267 (autoimmune diseases)

The goal of this project is to identify new chemical compounds that function according to the same mechanism as the Arava® product by Sanofi-Aventis currently on the market, but with lesser side effects. In specific, the liver toxicity of the product on the market and its effect on the digestive tract (diarrhoea) are to be strictly avoided to achieve significantly better tolerability and long-term compliance.

Alongside development candidate SC12267, 4SC AG has a large pool of proprietary potential backup substances in various stages of preclinical development.

Clinical phase I studies having indicated good tolerability and superior pharmacokinetics for lead compound SC12267 to the benchmark product Arava® with healthy subjects, in the reporting year 4SC AG initiated a clinical phase IIa study. The necessary preclinical studies on toxicology, metabolism and distribution were conducted to obtain study approval. A coated pill for oral administration was developed and the required stability data gathered before submission of the dossier to the responsible authorities and ethics committees. In December 2006 Germany's highest regulatory authority, the Federal Institute for Drugs and Medical Devices (BfArM), issued its approval. In this double blind, placebo-controlled study, patients with active rheumatoid arthritis are being administered SC12267 orally every day for a period of three months. Two different dosages of SC12267 are being used in this multi-centre study conducted in Germany, Poland and Serbia. The results of this proof of concept study are expected to be released in the fourth quarter of 2007.

SC68896 (cancer)

The compound Velcade® (Millennium), a so-called proteasome inhibitor, was approved in the US in 1998 as a third-line therapy for treating recurrent multiple myeloma (recurrences after healing completely). Sales of Velcade® quickly reached nearly USD 300 million, and today the drug remains the preferred choice for second and third-line treatment of this form of cancer. The clinical potential of such proteasome inhibitors is much greater according to recent studies, but is limited by Velcade®'s toxicity.

SC68896 is a new kind of small molecule proteasome inhibitor 4SC AG has developed over the course of the past few months. Unlike Velcade®, SC68896 does not contain chemically reactive groups, thus offering the potential of substantially better tolerability.

Because of its strong *in vitro* activity with tumour cells, its high tolerance factor and good pharmacokinetic properties, SC68896 and a number of similar compounds were studied in suitable preclinical models. It was the strikingly strong anti-tumour activity

against tumour cells from multiple myeloma patients however that led to the decision to formally prepare SC68896 for clinical development. In parallel, promising data was gathered on application with brain and lung tumours. Outlining of a production process for the compound and development of a suitable formulation were initiated. It should be possible according to current planning to prepare the dossier for applying for clinical trial approval before the end of 2007.

SC71570 (inflammation and cancer)

The NFκB signal pathway, which is responsible for communication between a host of cellular signal molecules, plays a key role in chronic inflammatory and autoimmune diseases. 4SC AG's successful research efforts in this field culminated in the reporting year in the selection of SC71570 as development candidate for the treatment of autoimmune and inflammatory diseases. Research showed that SC71570 evidenced impressive activity with rheumatoid diseases in animals, in addition to having a major impact on immune cells.

Safety and tolerability data also were a factor in the selection of this compound. Efforts are currently underway to work out a production process to allow conducting of the necessary safety testing prior to initial human trials. If this testing should proceed in accordance with expectations, approval for clinical trials could be applied for at the end of 2007.

4iP project (cancer)

The approval of Sutent®, a kinase inhibitor by Pfizer, in 2006 provided a stimulus to further research efforts on innovative kinase blockers. Kinases play a particularly important biological role in the treatment of cancer, as these proteins are key for the transmission of cellular signals. Efforts to develop new kinase inhibitors have thus far focused on blocking a specific kinase connected with a particular tumour, thereby producing a therapeutic effect. This aspect of selectivity however has limited the therapeutic potential of drugs like Gleevec® (Roche) and Gefinitib® (Astra Zeneca), which also involve a risk of acquired resistance. The 4iP project conducted jointly by 4SC AG and ProQinase GmbH headquartered in Freiburg is designed for the identification and development of multi-specific kinase inhibitors to attack tumours simultaneously from multiple sides.

The first positive data on the activity of 4iP substances in tumour models was demonstrated during the reporting year. A compound active against specific cancer cells in very low concentrations made existing tumours go into regression in mice. This compound, like other similar substances in the 4iP project, simultaneously affects a group of kinases responsible both for cell growth and the formation of new blood vessels ("angiogenesis") in tumours. The formation of metastases and penetration into tissues is also impeded.

SC75741, NFκB (inflammation and cancer)

4SC AG achieved other important goals in the field of NFκB inhibitors last year as well in addition to advances with SC71570. Collaborative efforts with the working group of Prof. Ludwig of the University of Münster revealed that some NFκB inhibitors developed by 4SC AG are quite effective at impeding the multiplication of influenza viruses. Activity with avian flu viruses and the highly pathogenic H5N1 strain in specific were furthermore demonstrated. In addition to the development of NFκB inhibitors for treating influenza and other RNA viruses, 4SC AG has developed a broad portfolio of drug candidates and backup substances providing a potential source for new treatments for chronic inflammatory bowel diseases ("IBD") or skin disorders like psoriasis and neurodermatitis.

Kv1.3 (multiple sclerosis)

This project for the identification of new multiple sclerosis (MS) drugs, funded in part by the Federal Ministry of Education and Research (BMBF), was driven forward during the reporting year. The Kv1.3 channel is found principally in immune cells that are key to the pro-

Collaborative efforts with the working group of Prof. Ludwig of the University of Münster revealed that some NFκB inhibitors developed by 4SC AG are quite effective at impeding the multiplication of influenza viruses.

gression of MS. Blocking the ion stream through the channel prevents multiplication of this type of immune cell and thus may be expected to have a positive impact on the course of the disease. Using this know-how the company was able to identify molecules that block both the Kv1.3 channel and the multiplication of immune cells at the submicromolar level.

Other projects

4SC AG initiated a series of new projects in the past year that are undergoing review for feasibility and success potential. These projects are directed towards a range of proteases, receptors and metabolic enzymes – all relevant targets for the treatment of chronic inflammation and cancer 4SC's therapeutic areas of specialisation.

Alongside the current projects being actively pursued, substances from other projects not involving chemical-synthetic development are also being characterised for commercial applications within a collaborative framework. One such effort, the Quorum Sensing Blocker project, was successfully integrated into the licensing agreement with the startup QuoNova LLC.

Quorum Sensing Blocker (bacterial infections)

4SC AG is a pioneer in the field of quorum sensing blockers (QSB). This innovative approach involves inhibiting cell-to-cell communication of gram-negative bacteria without having a toxic effect on them, suppressing bacterial virulence (formation of biofilms, releasing virulence factors such as toxins and enzymes).

The compounds synthesised and characterised by 4SC AG exhibiting high specific activity were successfully sold to the startup QuoNova LLC., Melbourne, Florida, USA.

Malaria

4SC AG was able to identify a number of highly efficacious anti-parasite substances as part of a project funded by the European Commission for the development of new drugs for the treatment of malaria. These substances are currently being tested by other EU scientists in the ANTIMAL consortium on appropriate animal models for their antiparasitic characteristics. A licensing agreement with a suitable development partner is planned in the event these efforts prove successful.

1.12 Measures for the protection of intellectual property

As of financial year-end, 4SC AG held seven registered patents and had filed for 112 patents worldwide. Four patents have now been granted for the crucial DHODH inhibitor technology (from South Africa, New Zealand and two from the USA), and a Notice of Allowance has been received from the USPTO for another application. These patents and patent applications encompass 37 patent families originally stemming from the same priority-establishing invention.

In addition to patents, 4SC AG owns a number of text and image trademarks. The company monitors usage of these trademarks, pursuing legal remedies for any violations as appropriate. The trademark "4SC" is protected in the European Union, the USA, Canada, Australia, Japan, China, Norway, and Turkey. The trademark "4SCan" is protected in the European Union. 4SC AG also holds logo rights in Germany.

1.13 Competitive environment

4SC AG operates in a multivalent competitive environment. On the one hand, the company competes against service-providing firms offering techniques and technologies for the acceleration of research and development processes for small molecular drugs. This category of competitors includes companies with core competencies in structure-based drug design and conventional high throughput screening such as Galapagos NV, Belgium, DeNovo Pharmaceuticals, UK and Evotec AG, Germany.

As the company's main growth potential lies in the proprietary drug candidates developed by the "Drug Discovery & Development" segment, the competitive environment also quite significantly includes providers of research and development services active in specific therapeutic fields. The company thus conducts regular market research in order to assess the specific competitive situation with regard to each individual therapeutic project. This includes in particular looking at pharmaceutical and biotechnology firms with proprietary project pipelines in the areas of oncology and autoimmune diseases. The company competes specifically with companies that employ integrated technology platforms to build up therapeutic pipelines and like 4SC AG pursue licensing partnerships with pharmaceutical companies for such projects to be concluded no later than clinical proof of concept.

This category includes such companies as Astex Pharmaceuticals, UK, Biocryst Pharmaceuticals, USA and Plexxicon, USA. Previous competitors of 4SC AG with similar business models like 3D-Pharmaceuticals and Syrrx have since been bought out by their respective partners Johnson & Johnson and Takeda.

1.14 Takeover provisions

The company's share capital consists of a single class of 11,461,365 (individual) zero par value common bearer shares without other rights or preferred status. The Management Board has not been authorised by shareholders

The company's share capital consists of a single class of 11,461,365 (individual) zero par value common bearer shares.

meeting to issue new shares from approved capital stock or to buy back shares. Major shareholders holding a voting stake of 10% or more currently are, to the company's knowledge: 3i Group Investments LP, London, UK, DVCG Deutsche Venture Capital Gesellschaft mbH & Co. Fonds II KG, Munich and VCG Venture Capital Fonds III Verwaltungs GmbH, Munich.
Sale of shares is restricted through a lock-up agreement with Conrad Hinrich Donner Bank, Hamburg, in connection with 4SC AG's stock exchange listing in December 2005. This lock-up agreement, expiring in phases by December 2007, still affects 4,508,624 or 39.34% of outstanding shares. The bank may however grant permissions for early sale.
The company has no other significant compensation or other anti-takeover provisions in place in the event of a change of control pursuant to a buyout offer. The only exception is pre-emptive purchasing rights enjoyed by QuoNova LLC.'s and its other shareholder, XL TechGroup LLC., for 4SC AG's shareholdings in QuoNova LLC. in the event of a change of ownership.

1.15 Management Board remuneration
Annual Management Board member remuneration consists of a non-performance-based remuneration and a performance-based bonus in addition to a long-term performance-based incentive in the form of stock options (ESOP = Employee Stock Option Programme).
Total remuneration to 4SC AG Management Board members came to KEUR 662 for financial year 2006, 76% of which represented fixed salary and 24% variable components.
The Supervisory Board sets bonus levels at its own prudent discretion on the basis of company business results and the degree of obtainment of predefined individual and general organisational objectives.
Current 4SC Management Board members held a total of 290,700 stock options and 808,986 shares as of 31 December 2006. Together current Management Board members hold 7.1% of company shares.
The Supervisory Board reviews the appropriateness of Management Boards remuneration annually.
A breakdown of individual Management Board member remuneration and detailed information on the stock option programme are provided on pages 68 and 70 in the Notes to the 2006 IFRS financial statements.

2. Presentation of the situation

2.1 Course of business

Business proceeded largely in line with expectations during the reporting year.

A clinical phase IIa study was started for our leading project SC12267, while other preclinical development candidates were advanced towards clinical phase I. The project portfolio was also further expanded.

Two "Collaborative Business" segment projects were successfully concluded and payment for milestone obtainment remitted accordingly involving Sanwa Kagaku Kenkyusho Co. Ltd., Nagoya, Japan, and Schwarz Pharma AG, Monheim. Ending of the urology collaboration with Schwarz Pharma additionally entailed transfer of project rights in return for a share of potential future licensing revenues. A new research partnership was simultaneously initiated with Schwarz Pharma for central nervous system disorders. Two new customers were also acquired: Solvay Pharmaceuticals GmbH, Hanover, and QuoNova LLC., Melbourne, Florida, USA.
In the segment "Drug Discovery & Development" sale of exclusive global rights to QSB substances served to confirm the 4SC AG business model, generating both revenues and future potential. Net sales were up significantly for both segments together, supporting 4SC AG's self-financing strategy.

Rising sales and earnings year-on-year were offset by a simultaneous increase in costs. The change in company assets and liabilities was roughly in line with expectations, but the net change in liquidity for the reporting year turned out negative, in contrast to 2005, in which major equity financing activities influenced net change in liquidity positively. This led to an overall decrease in the balance sheet total.

2.2 Earnings position

Net sales totalled EUR 3,664 for the reporting year, up KEUR 1,596 or 77.2% versus KEUR 2,068 for the year prior.
The "Drug Discovery & Development" segment posted net sales of KEUR 1,683 (2005: KEUR 132), up KEUR 1,551 year-on-year through the sale to QuoNova LLC. of exclusive global rights to 4SC AG's QSB substances. No significant licensing income was generated in the previous year.

The "Collaborative Business" segment posted net sales of KEUR 1,981 for the reporting year (2005: KEUR 1,936), up by KEUR 45 or 2.3%. The successful conclusion of two collaborations with Schwarz Pharma and Sanwa Kagaku Kenkyusho served to keep net sales steady at last year's level. These two partnerships accounted for 90% of 2006 net sales.
4SC AG results from operating activities rose by KEUR 807 year-on-year to KEUR - 5,530 from KEUR - 6,337 for the year prior. This result was obtained through increasing net sales and lower administrative costs totalling KEUR 2,254 (2005: KEUR 2,998). This development reflected the absence of one-time charges associated with listing on the stock exchange last year, with only a lesser amount of follow-up administrative expenses accruing in financial year 2006. Research and development costs increased to KEUR 5,708, mainly due to services contracted in connection with development of the project pipeline (2005: KEUR 4,259).
The financial result for the reporting year was KEUR - 10 (2005: KEUR 60). QuoNova LLC.'s period result of KEUR - 47 imputable to 4SC AG is shown as a loss from investments accounted for by the equity method. Financial income of EUR 235 (2005: KEUR 267) was generated primarily by cash invested in securities and interest-bearing money market bank accounts. Finance expenses of KEUR 198 (2005: KEUR 207) were principally the result of applying the effective interest method to long-term loans, interest payments to former silent partners and losses generated by the sale of securities.
The period result for the reporting year was KEUR - 5,540 (2005: KEUR - 6,277). Undiluted and diluted earnings per share amounted to EUR - 0.50 (2005: EUR - 0.77).

2.3 Net assets position

Non-current assets increased to KEUR 4,177 in the reporting year, up from KEUR 3,516 in the previous year. This increase was influenced chiefly by receivables from associated companies, which were up to KEUR 1,021 in the reporting year versus KEUR 162 for the previous year. Most of this amount is attributable to the long-term portion of proceeds from the sale to QuoNova LLC. of exclusive global rights to QSB substances. This particular account, valued at KUSD 2,000, is being paid off in accordance with a repayment schedule in annual instalments The short and long-term

Sale of exclusive global rights for QSB substances served to confirm the 4SC AG business model.

portions of the receivable are shown separately on the balance sheet. As of financial year-end, the long-term portion amounted to KEUR 923 (2005: KEUR 0). An additional item is KEUR 98 in receivables from the sale of a software package to quattro research GmbH in 2004 (2005: KEUR 162).

Other non-current assets include goodwill of KEUR 1,786 (2005: KEUR 1,786) resulting from the merging of 4SC GmbH into 4SC AG in the year 2000, and fixed assets (in particular lab and IT equipment, installations) of KEUR 1,230 (2005: KEUR 1,503). Depreciation of KEUR 571 (2005: KEUR 740) substantially exceeded new investment of KEUR 299 (2005: KEUR 76).

Current assets decreased to KEUR 5,796 (2005: KEUR 7,728), largely due to declining holdings of short-term securities, now totalling KEUR 4,007 (2005: KEUR 6,510), liquidated to raise cash for operating purposes.

Trade receivables decreased as of closing date to KEUR 134 (2005: KEUR 205). The short-term portion of the abovementioned receivables from the associated companies QuoNova LLC. and quattro research GmbH totalling KEUR 518 (2005: KEUR 21) is shown under current assets.

4SC AG's equity declined to KEUR 7,854 (2005: KEUR 9,159). The 11 May 2006 capital increase, raising net capital of KEUR 4,120, was insufficient to fully offset the period result for the year of KEUR - 5,540 (2005: KEUR - 6,277).

Long-term liabilities representing loans from former silent partners increased during the reporting year to KEUR 830 through application of the effective interest method (2005: KEUR 747).

Provisions totalled KEUR 564 on the balance sheet closing date (2005: KEUR 785), this reduction reflecting payment of obligations in connection with listing on the Frankfurt Stock Exchange in December 2005.

Trade payables rose to KEUR 499 as of closing date (2005: KEUR 271).

2.4 Financial position

Cash outflows from operating activities totalled KEUR 6,150 for the reporting year (2005: KEUR 5,725). This minor increase was primarily due to two contrary effects: The pre-tax result improved by 11,7% to KEUR - 5,540 for the reporting year. Receivables from associated companies also rose however by KEUR 1,356 (2005: KEUR - 35), reflecting in part the sale of exclusive global rights to QSB substances to QuoNova LLC., only resulting in cash flows in subsequent years.

Cash outflows from investing activities rose by KEUR 2,218 during the reporting year to KEUR 2,326 (2005: KEUR 108). Cash raised in the December 2005 stock exchange listing totalling KEUR 1,949 was invested in fixed and variable interest securities of high-rated issuers in financial year 2006 (2005: KEUR 0). Also, investment in fixed and intangible assets ran to a total KEUR 377 (2005: KEUR 109).

Cash inflows from financing activities for the reporting year came to KEUR 4,120 (2005: KEUR 10,653), deriving entirely from the 11 May 2006 capital increase. Multiple capital increases in the year prior raised a total of KEUR 11,444 in cash.

Levels of cash and cash equivalents fell by KEUR 4,356 year-on-year down to KEUR 2,522 (2005: KEUR 6,878) at year-end. The company's solvency was ensured at all times.

3. Risk and chance report

3.1 Risk management and internal control system

As a biotech company, 4SC AG operates in a technological environment that harbours alongside general business risks specific risks pertaining particularly to research and development, intellectual property, collaborations and financing issues. Individually or in combination, these risks can have a negative impact on 4SC AG's assets, finances and earnings.

4SC AG implemented a comprehensive computer-aided risk management and controlling system in 2002 to promptly identify potential risks and avoid negative impact to the firm. The system is maintained and optimised on ongoing basis.

This risk management system is an integral part of the company's corporate management and monitoring efforts. Risk reports generated by the system provide extensive quarterly information on a project and corporation level for the management and serve as a tool for the controlling of internal research and development projects. The individuals responsible for risk management regularly employ predefined risk management processes to identify, analyse and evaluate risks as to the probability of their occurrence, the scope of potential losses and possible avoidance measures. This information is reported by the Risk Management Officer to the Management Board to provide a basis for strategic decision-making concerning adequate response to any residual risks.

The internal system of controls involves other substantial elements in addition to risk management and the Finance & Controlling ERP system including crisis planning, mandatory review procedures and signature authorisation procedures. These effectively minimise residual risks.

The material individual risks outlined below are to certain extent interrelated, having a potentially ameliorating or aggravating effect.

3.2 Industry-specific risks

The industry in which 4SC AG operates is characterised by short technology cycles and a high level of innovation. Other technologies could come on the market in future allowing cheaper and/or more rapid development of new drug candidates.

4SC AG's business operations are subject to extensive regulatory constraints and controls. 4SC AG's ability to develop and market new drug candidates could potentially be compromised by administrative, regulatory or legislative processes largely beyond the control of 4SC AG.

4SC AG implemented a comprehensive computer-aided risk management and controlling system in 2002 to promptly identify potential risks and avoid negative impact to the firm.

3.3 Achieving profitability

As an enterprise specialising in research and development, 4SC AG has to generate substantial net sales from milestone payments, licensing income and royalties from licensing agreements with pharmaceutical and biotech partners and service collaborations to achieve profitability. 4SC AG's net sales have not thus far allowed the company to self-finance and achieve profitability. As research and development expenses will remain substantial, the company will continue to post negative operating results for the time being. 4SC AG needs to sign further deals with sizable partners from the pharmaceutical and biotech industries in order to become profitable in the medium term, which is why the company remains in regular dialogue with many such firms.

3.4 Additional financing

A capital increase was conducted in the spring of 2006 which served to secure adequate short-term financing for the company, laying a strong foundation for the attainment of its business and developmental objectives. 4SC AG will continue to require substantial capital in order to realise these business objectives, the availability of which will depend on a number of factors including in particular the ability to generate sufficient income from licensing or collaborations on an ongoing basis. Product development costs could exceed such income, requiring additional equity and debt financing. 4SC AG cannot offer any assurance that such financing will be obtainable at the point required, in the amount required, on economically

feasible terms, or under any circumstances. Adequate financing is however a prerequisite for the continued existence of the organisation as a going concern. In the event adequate financing should be unavailable or only available on unacceptable terms, 4SC AG could be forced to limit its research and product development expenditures, having a potentially negative impact on 4SC AG's assets, finances and earnings. Additional equity financing through the issuance of new shares of company stock could result in the dilution of existing shareholdings.

3.5 Handling of financial instruments

4SC AG adopts a conservative policy regarding investment of company cash, requiring diversification among low-risk capital investments with high credit ratings in order to effectively minimise price and default risk.

3.6 Service collaborations

A substantial portion of 4SC AG net sales for financial year 2006 derived from the "Collaborative Business" segment, through partnerships with Schwarz Pharma AG, Monheim, and Sanwa Kagaku Kenkyusho Co. Ltd., Nagoya, Japan. The conclusion of these joint projects in 2006 could negatively impact net sales, thus affecting the future financing and earnings situation. 4SC AG is thus working on identifying new collaboration partners and initiating new projects with existing partners, pursuing active customer acquisition.

3.7 Industrial property rights for the protection of drug candidates

Generating intellectual property and implementing broad patent and licensing strategies is a cornerstone of the company's strategy to protect proprietary technologies and developments. It cannot be ruled out that third parties may successfully contest the validity of patents in part or as a whole, even after their issuance. The mere assertion of third parties that 4SC AG patents or patent applications may be contestable can have a negative effect on net sales, thereby affecting company finances and earnings. Furthermore, it cannot be ruled out that 4SC AG may become embroiled in patent litigation with third parties, necessitating filing of actions to defend proprietary intellectual property or to pre-empt third-party patents and patent applications potentially compromising 4SC AG's developmental efforts. To avoid such generally protracted and expensive litigation, 4SC AG employs a strategy of careful monitoring of competitor patents and of application submission designed to clearly establish patent-protected claims at an early stage.

3.8 Product development risks

As a product-oriented biotechnology enterprise, 4SC AG is subject to developmental risks typical of the industry resulting from the long development times associated with drug discovery. One product candidate is currently in clinical phase IIa, four projects in preclinical and another in the research phase. The risks are that individual drug candidates may not prove efficacious, may involve excessive side effects or be temporarily or permanently denied mandatory regulator approval.

4SC AG's drug candidate in the most advanced stage of development at this time is SC12267, a compound for the treatment of chronic inflammatory diseases such as rheumatoid arthritis. Two clinical phase I studies have been successfully conducted on SC12267, which now is in a clinical phase IIa study investigating its therapeutic efficacy and safety as a treatment for patients with rheumatoid arthritis. 4SC AG cannot rule out that SC12267 may prove insufficiently active in use with patients, or that initial usage of the compound with patients may trigger unexpected side affects posing a safety concern. The severity and frequency of such safety concerns could delay study results significantly or cause the study to be abandoned. This would have a direct impact on the company's enterprise value and potentially its ability to obtain financing on the capital markets.

4SC AG's strategy is to reduce these risks as much as possible through a broadly diversified, risk-balanced portfolio of research and deve-

Generating intellectual property and implementing broad patent and licensing strategies is a cornerstone of the company's strategy to protect proprietary technologies and developments.

lopment projects. 4SC AG thus regularly evaluates all of its projects in order to reduce intrinsic portfolio risks.

3.9 Marketing collaborations

A key part of 4SC's strategy is to enter collaboration partnerships or licensing agreements with experienced industry partners for the advanced clinical development and subsequent marketing of both existing and future drug candidates in the near future. If 4SC AG does not succeed in concluding such collaboration partnerships or licensing agreements on commercially acceptable terms, the development and marketing of drug candidates could be delayed and development and marketing costs rise. In addition, 4SC AG could potentially miss out on milestone payments or licensing fees in the event a collaboration or licensing partner should fail to successfully develop or market a 4SC AG drug candidate, impacting finances and earnings accordingly.

The company for this reason presents its projects to marketplace participants at an early stage. Numerous talks underway with a range of potential partners in the pharmaceuticals industry are indicative of a high level of interest in 4SC AG drug candidates.

3.10 Key personnel and holders of know-how

The success of 4SC AG as a firm depends to a large extent on its key managers and scientific and technical personnel. Many of these employees have extensive experience at the firm and would be hard to effectively replace. Although competition for highly skilled personnel is intense in the biotechnology industry, 4SC AG has thus far always succeeded in filling the relevant positions with suitable individuals on reasonable employment terms. Losing certain key managerial, scientific or technical personnel could have a negative impact on 4SC's competitiveness. In addition to paying competitive salaries, 4SC AG employs such tools as employee stock option programmes and active personnel and leadership work in order to actively support retention of staff. The company deliberately implements clear managerial structures and utilises an extensive range of management instruments which are optimised on an ongoing basis.

3.11 Currency risks

4SC AG conducts transactions in non-euro (EUR) currencies with a number of international business partners. This subjects 4SC AG to the risk of potential exchange rate fluctuation relative to the euro during the period between invoicing and due date. 4SC AG may also need to conclude agreements requiring payments to or by 4SC AG in non-euro currencies, involving exchange rate risks that may not be hedgeable on reasonable terms.

3.12 Value enhancement through project advancement

Plans are for a number of 4SC AG drug candidates to reach important development milestones over the short to medium term, enhancing the value of the respective projects and hence the enterprise value overall. This would be the case in particular upon project candidates entering clinical development or successfully concluding study phases.

3.13 Value enhancement through external partnerships

4SC AG conducts extensive regular talks with potential partners in the pharmaceuticals industry. With numerous patents protecting existing products expiring and new drug failures affecting the pharmaceutical industry, drug companies are generally looking to conclude

4SC AG's research and development efforts have often illustrated how a single development candidate can function as a platform.

collaboration and licensing deals for new discovery projects earlier in the development process. The terms of such partnerships between pharmaceutical and biotechnology companies are becoming increasingly favourable for biotech companies. 4SC AG's project portfolio is likely to benefit from this trend. Such partnerships could additionally validate 4SC AG's projects and – dependant on the contract – would potentially improve the company's overall net assets, financial and earnings position.

3.14 Buyout prospects

While interest in drug candidates in early development phases is increasing, in recent years large pharmaceutical and biotechnology companies have been increasingly opting for outright buyouts to obtain attractive technologies. The premiums paid above market price are usually considerable; 4SC AG shareholders could benefit accordingly.

3.15 One candidate – multiple projects

4SC AG's research and development efforts have often illustrated how a single development candidate can function as a platform upon which a variety of different projects involving different drug candidates for varying applications can be built. In the short term, this could give rise to an expansion of the project pipeline, thus further diversifying risk and potentially enhancing value.

3.16 Acute medical need creating demand

During the last two years, the threat of a flu epidemic has shown the immediate positive impact current events can have on the value of ongoing 4SC AG projects.

With its NFκB project, 4SC AG has a promising drug candidate for combating influenza viruses that is undergoing systematic development. As staving off the threat of a flu epidemic remains an issue of widespread concern, this project holds considerable potential.

3.17 Licensing income from structural patents

4SC AG's broad and well-positioned patent portfolio has the potential for generating additional licensing income, as other developers may be forced to obtain licenses in order to advance their own projects. Such licensing income would improve the company's overall net assets position.

3.18 Investments with appreciation potential

4SC AG holds equity stakes in the companies quattro research GmbH headquartered in Planegg-Martinsried and QuoNova LLC., Melbourne, Florida, USA. The shares held by 4SC AG could appreciate in value if these companies perform well. The investment in QuoNova LLC., which bought the rights to 4SC AG's QSB substances in late 2006 holds particular potential. QuoNova's largest shareholder, the american XL TechGroup, has a track record of building up similar startups which have gone public within only a few years. This holding thus offers value enhancement potential for 4SC AG over the medium term.

4. Events after the end of the financial year

At the 5th GTCBio Cytocines & Inflammation Conference in late January 2007 4SC AG announced having nominated a compound designated SC71570 as a development candidate for the treatment of rheumatoid arthritis in connection with its NFκB project, which is now undergoing systematic preparation for clinical development.

It was also reported in early February that the U.S. Patent and Trademark Office (USPTO) issued patent number 7,176,241 to 4SC's drug candidate SC12267. This protects the DHODH inhibitor developed for the treatment of rheumatoid arthritis.

5. Business outlook

5.1 Overall economic outlook

The global economy remains on track for growth, the International Monetary Fund (IMF) projecting 4.9% global growth for 2007 in its World Economic Outlook (9/2006), with emerging markets leading the way at a projected 7.2% including China at 10%. The report projected 2.9% growth for the US economy, down somewhat from 2006. The Eurozone is expected to post around 2% growth. Other studies also foresee a relatively stable continuation of the economic upturn in the Eurozone at over 2% growth, barring minor slowing in the first half of the year.

Inflation remains a worldwide concern in 2007, which central banks will be poised to react to, as in 2006.

The dampening effect of the VAT tax hike in Germany effective January 2007 appears less severe than initially feared, and will only be temporary according to expert opinion. At the end of last year German economic growth was forecast between 1.0% and 1.8% (GDP) for 2007, which appears nearly within reach based on the statistical overhang from 2006 alone. It is thus probable that estimates will soon be revised upward. Recent studies and surveys are confirming this increasingly positive trend.

The German Central Bank sees risks for the global economy in the potential implementation of additional protectionist measures, a renewed rise in oil prices and the potential for global economic imbalances leading to uncontrolled negative developments.

5.2 Biotechnology outlook

The first weeks of the year 2007 proceeded favourably for the biotech industry. A positive basic mood with respect to the global economy and financial markets is providing an excellent backdrop for further industry growth. Major financing has been obtained both from stock markets and private venture capital, which appears to be increasingly stabilising as a key market for young biotechnology firms with the inception of new funds. Investors remain selective however, and better-capitalised firms will continue to dominate. Small caps will still have a much harder time attracting investor attention.

New development and marketing collaborations deals have also been signed. The extreme pressure in the pharmaceuticals industry to take action is providing increasing opportunities to biotech firms to find partners for drug candidates in preclinical and early clinical stages on attractive agreement terms. More M&A activity will thus be in the offing, as pharmaceutical and biotech companies vie to win advanced technologies or even entire discovery pipelines. Industry consolidation will thus proceed unabated.

Many firms continue to suffer from chronic underfinancing in Europe in particular, and the number of startups able to attract investor interest remains few. This could result in a death of new technologies and discoveries in the medium term.

On the whole the industry is on track however, with increasing numbers of clinical development candidates and product approvals as well as rising revenues likely in store. The trend of biotech occupying an increasingly larger role within the life science sector remains in place.

5.3 Company outlook

5.3.1 Research, development & collaborations

For 2007 plans in the "Drug Discovery & Development" segment are to conclude the clinical phase IIa study for drug candidate SC12267 (DHODH) started in late 2006 and evaluate results. 4SC AG is in talks with a number of potential pharmaceuticals partners for a licensing deal for the further development and marketing of the drug candidate leading up to and following approval.

Preclinical studies are currently underway for two other internal projects which upon successful conclusion are to provide the basis for commencement of clinical development. 4SC AG has likewise initiated talks with potential partners regarding these projects with a view to generating net sales early on through co-development and licensing deals while securing long-term profit potential. In 2007 4SC AG will continue to implement its strategy, launched in 2006, of generating a majority of income through the "Drug Discovery & Development" segment with a medium-range time horizon. The success of this strategy may depend on the realisation of a handful of important business transactions.

In the "Collaborative Business" segment, new projects for future collaborations with existing partners are to be identified in financial year 2007 and the customer base shall be expanded. This segment is to operate profitably on its own net sales, as it has in the past. The research and development partnership with QuoNova LLC., Melbourne, Florida, USA, begun in late 2006 should go a long way in this respect, 4SC AG providing substantial research capacity for further development services in connection with the QSB project.

5.3.2 Employees

4SC AG has adequate staffing levels at this time to implement its ongoing developmental efforts and projects. In addition to filling some of vacated posts, several new positions are also being created for new recruits. On balance, staffing levels are expected to remain largely stable for the present.

5.3.3 Financial goals

The evolving project pipeline, involving rising development costs, particularly for projects in clinical phases, reflects the maturation process 4SC AG is going through. Successful developmental progress translates into increasing potential for generating licensing and other revenues.

For financial year 2007 the company anticipates posting a net loss. Based on the current status of ongoing projects and negotiations it expects the partnerships in "Collaborative Business" segment and licensing income from the "Drug Discovery & Development" segment to generate significant sales; this should mean an improved bottom-line result for 2007 versus 2006. Over the medium to long term, the "Drug Discovery & Development" segment should become the primary revenue generating unit. Financial planning is complicated however not only as concerns the precise timing of predicted future events, but also as to the manner in which such events are to be accounted for in view of contract terms.

4SC AG sees itself as well-positioned

to achieve its strategic,

commercial and scientific research objectives.

The company's financing over the next twelve months is secure, consisting primarily of funds raised in 2005 and 2006 and net sales expected to be generated by the two business segments. Plans are to cover any additional financing needs through the issuance of further equity stock.

4SC AG sees itself as well-positioned to achieve its strategic, commercial and scientific research objectives. Management believes that the company's business will continue to strengthen in both the short and medium term with the signing of new sales-generating licensing deals and service and research collaborations.

Management Board of 4SC AG (from left to right): Dr Daniel Vitt, Dr Ulrich Dauer, Dipl.-Kfm. Enno Spillner and Dr Gerhard Keilhauer

Planegg-Martinsried, 02 March 2007

Dr Ulrich Dauer, CEO

Dr Gerhard Keilhauer, CDO

Dipl.-Kfm. Enno Spillner, CFO

Dr Daniel Vitt, CSO

FINANCIAL STATEMENTS OF 4SC AG (IFRS)

Income statement

for the financial year from 1 January to 31 December 2006

in KEUR	2006	2005	Notes
Net sales	3,664	2,068	4.1
Cost of sales	- 572	- 600	4.3
Gross profit	**3,092**	**1,468**	
Distribution costs	- 518	- 433	4.4
Research and development costs	- 5,708	- 4,259	4.5
Administrative costs	- 2,254	- 2,998	4.6
Other operating income	31	32	4.7
Other operating expenses	- 173	- 147	4.8
Result from operating activities	**- 5,530**	**- 6,337**	
Financial result			4.10
Loss from investments accounted for by the equity method	- 47	0	
Finance income	235	267	
Finance expenses	- 198	- 207	
Financial result	**- 10**	**60**	
Period result	**- 5,540**	**- 6,277**	
Earnings per share (undiluted and diluted; EUR)	- 0.50	- 0.77	6.

Balance sheet – Assets

for the financial year ended 31 December 2006

in KEUR	2006-12-31	2005-12-31	Notes
ASSETS			
Non-current assets			
Intangible assets	1,875	1,851	7.1
Fixed assets	1,230	1,503	7.2
Investments accounted for by the equity method	51	0	7.3
Receivables from associated companies	1,021	162	7.4
Total non-current assets	**4,177**	**3,516**	
Current assets			
Inventories	17	14	7.5
Trade receivables	134	205	7.6
Receivables from associated companies	518	21	7.4
Cash	464	368	7.7
Securities	4,007	6,510	7.8
Other current assets	550	374	7.9
Prepaid expenses and accrued income	106	236	7.10
Total non-current assets	**5,796**	**7,728**	
TOTAL ASSETS	**9,973**	**11,244**	

Balance sheet – Equity and liabilities

for the financial year ended 31 December 2006

in KEUR	2006-12-31	2005-12-31	Notes
EQUITY AND LIABILITIES			
Equity			7.11
Subscribed capital	11,461	10,530	
Additional paid-in capital	16,607	13,303	
Retained earnings	67	67	
Loss carryforward	- 14,741	- 8,464	
Period result	- 5,540	- 6,277	
Total equity	**7,854**	**9,159**	
Non-current liabilities			
Long-term loans	830	747	7.12
Total non-current liabilities	**830**	**747**	
Current liabilities			
Provisions	564	785	7.13
Trade payables	499	271	7.15
Accounts payable to associated companies	29	29	7.16
Down payments received	37	0	7.17
Other current liabilities	160	253	7.18
Total current liabilities	**1,289**	**1,338**	
TOTAL EQUITY AND LIABILITIES	**9,973**	**11,244**	

Cash flow statement

for the financial year from 1 January to 31 December 2006

in KEUR	2006	2005	Notes
Cash flows from operating activities:			8.1
Period result before taxes	- 5,540	- 6,277	
Corrections for:			
Depreciation on fixed assets and intangible assets and impairment of goodwill	625	819	
Non-cash affecting expenses and income	- 19	344	
Financial result	10	- 60	
Non-cash affecting change of end remuneration claims	0	- 279	
Repayment of end remuneration claims	0	- 292	
Interest received	192	37	
Interest paid	- 35	- 206	
Decrease/Increase of trade receivables	71	- 156	
Decrease/Increase of accounts receivable from associated companies	- 1,356	35	
Decrease/Increase of inventories	- 3	1	
Increase of other current assets	- 176	- 136	
Decrease/Increase of prepaid expenses and accrued income	130	- 152	
Increase of trade payables	228	149	
Increase/Decrease of down payments received	37	- 225	
Increase/Decrease of provisions	- 221	643	
Increase/Decrease of other current liabilities	- 93	30	
Cash flows from operating activities:	**- 6,150**	**- 5,725**	
Cash flows from investing activities:			8.2
Purchase of intangible assets	- 78	- 33	
Purchase of fixed assets	- 299	- 76	
Proceeds from sale of fixed assets	0	2	
Interest paid for financial leasing	0	- 1	
Purchase of securities	- 1,949	0	
Cash flows from investing activities:	**- 2,326**	**- 108**	

>

in KEUR	2006	2005	Notes
Cash flows from financing activities:			8.3
Payments to subscribed capital	931	2,434	
Payments to additional paid-in capital	3,189	9,010	
Payments from issuance and redemption of convertible bonds	0	- 21	
Financial leasing obligations	0	- 41	
Repayment of liabilities due to silent partners	0	- 729	
Cash flows from financing activities:	**4,120**	**10,653**	
Net change in cash and cash equivalents	**- 4,356**	**4,820**	
+ Cash and cash equivalents at the beginning of the period	6,878	2,058	
= Cash and cash equivalents at the end of the period	**2,522**	**6,878**	

The cash flow statement was prepared in accordance with the provisions of IAS 7.

The cash and cash equivalents break down as follows:

in KEUR	2006	2005	Notes
Cash and cash equivalents	464	368	7.7
Securities	4,007	6,510	7.8
./. maturity > 3 months	- 1,949	0	
	2,522	**6,878**	

Statement of changes in equity

for the financial year from 1 January to 31 December 2006

in KEUR	Subscribed capital	Additional paid-in capital shares	Additional paid-in capital WSV[1]	Additional paid-in capital ESOP[2]	Retained earnings	Loss carryforward/ Period result	Total
Balance on 2005-01-01	**6,956**	**1,302**	**12**	**78**	**67**	**- 8,464**	**- 49**
Payments into additional paid-in capital due to capital increase of 29 December 2004		229					229
Issued options (ESOP 2001 / 2003)				23			23
Issued options (ESOP 2004 / 2004)				14			14
Issued convertible bonds to the Supervisory Board				2			2
Payments into additional paid-in capital due to capital increase of 29 December 2004 (2nd tranche)		894					894
Capital increase of 6 June 2005	392	1,268					1,660
Exercise of convertible bonds	786	1,714					2,500
Redemption of convertible bonds to the Supervisory Board			- 1				- 1
Issued options (ESOP 2004 / 2005)				3			3
Capital increase of 28 September 2005	2,396	7,765					10,161
Period result 2005						- 6,277	- 6,277
Balance on 2005-12-31	**10,530**	**13,172**	**11**	**120**	**67**	**- 14,741**	**9,159**
Issued options (ESOP 2001 / 2003)				18			18
Issued options (ESOP 2004 / 2004)				20			20
Issued options (ESOP 2004 / 2005)				15			15
Capital increase of 11 May 2006	931	3,189					4,120
Issued options (ESOP 2004 / 2006/1)				3			3
Issued options (ESOP 2006 / 2006/2)				36			36
Issued options (ERSATZ-ESOP 2001)				23			23
Period result 2006						- 5,540	- 5,540
Balance on 2006-12-31	**11,461**	**16,361**	**11**	**235**	**67**	**- 20,281**	**7,854**

1: WSV = convertible bonds; 2: ESOP = Employee stock option programme for employees and Management Board

Additional explanations concerning the components of and changes in equity can be found in “7.11 Equity”.

Notes to the financial statements 2006

for the financial year from 1 January to 31 December 2006

1. Business activity

4SC AG, headquartered at Am Klopferspitz 19a, 82152 Planegg-Martinsried, is registered in the Commercial Register of the Munich Municipal Court under HRB no. 132917. A Commercial Register excerpt of 22 January 2007, with the most recent entry dated 11 July 2006, has been received.
The version of the Articles of Association dated 28 June 2006, is in effect.
The shares of 4SC AG are listed under the stock exchange abbreviation VSC, securities identification number 575381 and ISIN DE0005753818, on the Regulated Market in the Prime Standard Segment of the Frankfurt Stock Exchange.
The purpose of the enterprise is the identification, research and optimisation of active agents and the development, use and marketing of chemical, biotechnological and computer processes.
The company is authorised to engage in all transactions that are expedient to and foster the achievement of the corporate purpose. For this purpose it is also permitted to found, acquire, obtain equity interests in and assume the management of other enterprises domestically and abroad, lease companies or business operations, conclude inter-company agreements, particularly profit transfer and control contracts, and establish branch offices and field offices domestically and abroad.
The financial year is the calendar year.

2. Basis of preparation and significant accounting and valuation policies

2.1 Basis of preparation

These annual financial statements were created in full compliance with International Financial Reporting Standards (IFRS) as established by the International Accounting Standards Board (IASB). The recommendations issued by the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) were observed, as well as all IFRS adopted by the European Commission. New standards issued by the IASB are applied without exception starting in the financial year in which their application becomes mandatory.

The following standards and interpretations were new issued in the financial year 2006: IFRIC 8 (Scope of IFRS 2 – effective 1 May 2006), IFRIC 9 (Reassessment of Embedded Derivatives – effective 1 June 2006), IFRIC 10 (Interim Financial Reporting and Impairment – effective 1 November 2006), IFRIC 11 (IFRS 2 Group and Treasury Share Transactions – effective 1 March 2007), IFRIC 12 (Service Concession Arrangements – effective 1 January 2008) and IFRS 8 (Operating Segments – effective 1 January 2009). These new issued standards and interpretations, not applied in financial year 2006, as well as IFRS 7 (Financial Instruments: Disclosures – effective 1 January 2007) and IAS 1 (Capital Disclosures amendment – effective 1 January 2007), will either never be applicable to 4SC AG or appear on the basis of current circumstances to have no material impact on the company's net asset, financial and earnings situation.

In producing these annual financial statements it was necessary for Management to make estimates and assumptions impacting the disclosed value of assets and liabilities, the disclosure of uncertain assets and contingent liabilities as of the balance sheet date as well as expenses and income within the reporting period. Actual values may vary from such estimated values.

Management makes such discretionary decisions in estimating the value of loss-carryforwards with regard to offsetability against future earnings, in writing down receivables where the collectability of such is in question and in determining potentially impairment of goodwill. In performing compulsory estimation of value-in-use with regard to the latter, 4SC AG has to project future cash flows for cash generating units and determine the discount rate to be applied.

Management furthermore has to assess whether it exercises control with regard to the companies quattro research GmbH, Planegg-Martinsried, and QuoNova LLC., Melbourne, Florida, USA, thus being subject to consolidated reporting in accordance with IAS 27. Management has determined that the conditions have not been fulfilled constituting control of quattro research GmbH and QuoNova LLC. Nor have the conditions been met in Management's view for a consolidation of quattro research GmbH and QuoNova LLC. as special purpose entity in accordance with SIC-12.

4SC AG classifies assets and liabilities as current that are expected to be liquidated or redeemed within the twelve months following the balance sheet date, are held primarily for trading purposes or constitute cash and cash equivalents.

These are the individual annual financial statements for 4SC AG with registered office in Germany, including the companies quattro research GmbH, Planegg-Martinsried and QuoNova LLC., Melbourne, Florida, USA associated with 4SC AG.

The reporting currency is euros; the degree of precision used in the presentation is thousand euros (KEUR).
Foreign currency transactions are initially valued at the spot price for the respective transaction date (IAS 21.21). Foreign currency positions are valued in the reporting currency on each balance sheet date in accordance with IAS 21.23.

The Management Board approved the annual financial statements for release on 02 March 2007. The Supervisory Board is authorised to revise the annual financial statements after approval by the Management Board.

2.2 Significant accounting and valuation policies

The following accounting and valuation policies were material in the drawing up of the annual financial statements.

4SC AG applied these accounting and valuation methods uniformly for similar transactions, other events and contingencies.

Intangible assets
Intangible assets acquired are initially recognised at historical cost. Thereafter, intangible assets are recognised at historical cost less cumulative, linear amortisation. Research costs are reported as an expense in the period incurred. Intangible assets developed in the course of individual projects are only capitalised once technical feasibility of their production is given and if there is a demonstrable intent to produce, utilise or sell such. The criteria for capitalisation of development costs in accordance with IAS 38.57 have not been met.

Goodwill
Goodwill reported in the balance sheet under intangible assets derives from merging 4SC GmbH into 4SC AG in the year 2000. In capitalising goodwill the company has made use of a de facto accounting option with regards to the method used. Goodwill was recognised at historical cost and amortised via the straight-line method over a useful life of 10 years until the end of financial year 2004. IFRS 3 rules have been adopted for financial years after 1 January 2005. IFRS 3.79 is the applicable transitional rule. Goodwill amortisation was ceased in financial year 2005, upon which the carrying value of the cumulative amortised goodwill was computed and goodwill reviewed at least annually for impairment in accordance with IAS 36. An impairment of goodwill is reportable when the recoverable amount is less than the carrying value of the asset. The recoverable amount of an asset is the higher market value less transaction costs and value in use. As goodwill does not generate independent cash flows, the recoverable amount for the cash generating unit relevant to such goodwill or to which it can be most appropriately

attributed is determined. 4SC AG allocates this goodwill to the DHODH project as the cash generating unit for the purpose of impairment testing. In impairment testing, the value in use of the DHODH project is compared against the carrying value of goodwill. A risk adjusted cash flow projection is employed to determine value in use covering the future period through expiry of the project patents in 2020. The cash flows determined are discounted applying a risk-adjusted discount rate in line with market conditions. The discount rate, probability of market entry and projected market share are key factors for projecting cash flow and thus for determining value in use.

Abandoning the practise of amortisation has improved the period result since financial year 2005 by KEUR 357 – before taking into account contingent amortisation due to impairment testing.

Fixed assets
Fixed assets are recognised at historical cost and depreciated using the straight line method. The book values of fixed assets are tested for impairment whenever there are indications that asset book value may exceed recoverable value. The useful lives of and depreciation methods applied to fixed assets are reviewed and adjusted as necessary at the end of each financial year. Changes in fixed and intangible assets are shown under item '7.2. Fixed Assets' in the asset schedule in accordance with IAS 16.73.

Borrowing costs
Borrowing costs per IAS 23.4 are not include into acquisition cost, but rather recognised as an expense applying the benchmark method in accordance with IAS 23.7.

Receivables from associated companies
Receivables from associated companies are recognised at historical cost as of the date consideration was rendered. Receivables from associated companies are reduced by the amounts repaid in accordance with prearranged repayment schedules. Repayment schedule payments are shown as either current or noncurrent assets. Noncurrent assets representing receivables from QuoNova LLC. are recognised at amortised historical cost applying the effective interest method, as they are non-interest-bearing. The effective interest method is not applied to receivables from quattro research GmbH as interest is charged on these at market rates.

Financial assets accounted for by the equity method
The company quattro research GmbH of Planegg-Martinsried, in which 4SC AG holds a 48.8% stake, was founded in January 2004. As 4SC AG only appoints one of the three Advisory Board members of quattro research GmbH, it does not exercise a controlling influence on the company's business. The share held in this associated company is thus reported in accordance with IAS 28 applying the equity method. The balance sheet date and accounting and valuation methods employed for similar business transactions and events are the same for 4SC AG and this associate.

4SC AG sold its exclusive global rights to its QSB substances to QuoNova LLC. on 28 December 2006. In addition to the sale proceeds 4SC AG also received shares in QuoNova LLC. amounting to a 10% direct holding. Because 4SC AG exerts a significant influence on QuoNova LLC. on the basis of occupying executive committee positions and material business transactions with QuoNova LLC., shares in the company as an associate are reported using the equity method in accordance with IAS 28. The balance sheet date of 4SC AG and this associate correspond.

Inventories
Inventories of raw, supply and operational materials are recognised at the lower of historical or production cost and net sale proceeds in accordance with IAS 2.9. The FIFO method is applied for inventories in accordance with IAS 2.27.

Trade receivables
Trade receivables are recognised at the original invoiced amount less allowances for bad debts. Allowances for bad debts are performed based on Management's assessment of the collectability of specific customer accounts.

Cash and cash equivalents
Cash and cash equivalents are comprised of cash on hand, bank account credit balances and short-term deposits.

Securities
Securities are classified as 'at fair value through profit or loss' in accordance with IAS 39.9. They serve the interest-bearing investment of current liquidity reserves.
Securities are recognised at historical cost plus transaction costs in accordance with IAS 39.43 and recognised at the applicable market value in trading as of the balance sheet date. Changes in the applicable market value are posted as income on the income statement. Acquisitions and sales are entered in the balance sheet at the price applicable on the date of trading.
Securities are extremely liquid financial investments that can be converted into specific cash amounts at any time and are subject to moderate fluctuations in value.

Long-term loans
Long-term loans are recognised at the applicable market value, discounting the repayable amount at a risk-adjusted market interest rate commensurate with the respective maturities. After initial recognition, long-term loans are recognised at amortised historical cost applying the effective interest method.

Provisions and deferred liabilities
Provisions are created in accordance with IAS 37.14 whenever current legal or factual obligations exist arising from a historical event, an outflow of resources is probable and a dependable estimate of the obligation amount is possible. Provisions created are reported on the income statement as expenses.

Trade payables

Trade payables are current liabilities in accordance with IAS 1.60, which consequently are recognised at the repayment amount. Trade payables are derecognised when the underlying debt obligation has been discharged or expires. Foreign currency payables are valued as of the balance sheet date.

Down payments received

As future obligations to provide research services, down payments received from customers are reported separately as liabilities at the value of consideration due. These items are reclassified and recognised as income in proportion to the progress of contractual services fully rendered.

Revenue recognition

4SC AG generates net sales in the form of one-time payments, milestone payments, royalties and licensing fees in connection with research and cooperation agreements concluded by the company.

Research services performed under research and cooperation agreements are generally billed as a flat fee per individual research staff member (FTEs) per service type. The number of FTEs is agreed upon in advance in the cooperation agreements. Amounts received prior to the rendering of services are recognised as down payments received before being written back and recognised as income as of the period reporting date in accordance with the current progress of services rendered as per project management.

Upfront payments are received at the start of cooperations, representing advance payment following contract signing without specific services having been performed. Net sales from down payments are recognised as deferred revenue liabilities and recognised as income proportionately over the contract duration.

Milestone payments are received based on the obtainment of contractually pre-determined targets. Obtainment of these milestones depends largely on meeting specific requirements, so that the resulting net sales are only booked as such once contractual milestones have been fully achieved and confirmed by the business partner.

Royalties are income from the sale of products and product candidates in connection with research performed pursuant to cooperation agreements. Royalties are recognised as net sales as of the date upon which the cooperation partner generates external sales generating royalties.

Income from licenses granted for specific, contractually defined periods is posted as licensing fee income and recognised accordingly as net sales.

Licenses irrevocably sold are posted as net sales in the full amount as of the date of transfer of usage rights.

Services provided in the “Collaborative Business” segment are recognised as net sales on an ongoing basis in proportion to the progress of services rendered. Deferred licensing fees from the “Drug Discovery & Development” segment are recognised upon transfer of usage rights to the licensee and progressively recognised as net sales over the duration of the license.

IAS 11 does not apply, as the construction of long-term, customer-specific assets in accordance with IAS 11.3 and IAS 11.5 is not concerned.

Cost of sales
Personnel, materials and other costs incurred directly attributable to generation of net sales constitute cost of sales.

Distribution, research and development and administrative costs
The following costs are classified as distribution, research and development and administrative costs:

- Direct personnel and materials costs
- Depreciation
- Other direct costs
- Prorated overheads

Public grants
Public grants are recognised as income according to schedule, in accordance with IAS 20.12 in the period during which funded expenditures are incurred. As funding represents reimbursement of research expenditures, such amounts offset research and development costs for the relevant periods; specific explanations are provided in the Notes.

3. Segment report

The following segment reporting has been prepared in accordance with the principles of IAS 14.
The primary segment report format is the business segments in which 4SC AG is active. According to IAS 14.26, the secondary report format is geographical segments.
4SC AG is active in the two business segments of "Drug Discovery & Development" and "Collaborative Business." In the "Drug Discovery & Development" segment, 4SC AG is the holder of proprietary and patent rights and decides on the progress of projects. In contrast, the cooperation partner in the "Collaborative Business" segment is the holder of proprietary and patent rights and decides on project progress.

Segment report according to business segments:

in KEUR	Drug Discovery & Development		Collaborative Business		Not assigned		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	1,683	132	1,981	1,936	0	0	3,664	2,068
Personnel expenses	- 1,861	- 1,633	- 473	- 543	- 1,359	- 1,393	- 3,693	- 3,569
Depreciation	- 356	- 497	- 161	- 211	- 108	- 111	- 625	- 819
Other income and expenses	- 2,878	- 1,430	- 594	- 612	- 1,404	- 1,975	- 4,876	- 4,017
Segment result/result from operating activities	**- 3,412**	**- 3,428**	**753**	**570**	**- 2,871**	**- 3,479**	**- 5,530**	**- 6,337**
Financial result							- 10	60
Period result							**- 5,540**	**- 6,277**
Other information:								
Segment asset	704	1,091	359	584	8,910	9,569	9,973	11,244
Segment liabilities	37	0	0	0	2,082	2,085	2,119	2,085
Investments	223	31	59	31	95	47	377	109

In particular, the administrative costs are not assigned. Only net sales with external customers will be realised and shown.

Net sales according to headquarters of the performance recipient:

in KEUR	USA		Germany		Japan		EU		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	1,786	2	1,037	1,371	841	450	0	245	3,664	2,068

Germany is the geographical location of the overall segment assets and the segment investments.

4. Notes to the income statement

4.1 Net sales

in KEUR	2006	2005	Change
Drug Discovery & Development	1,683	132	1,175.0%
Collaborative Business	1,981	1,936	2.3%
	3,664	**2,068**	**77.2%**

The overall increase in net sales was attributable to rising net sales in the "Drug Discovery & Development" segment.
Net sales for the "Drug Discovery & Development" segment totalled KEUR 1,683 (2005: KEUR 132) for the reporting year, an increase of KEUR 1,551 versus the year prior, due to sale of 4SC AG's exclusive global rights to QSB substances to Quo-Nova LLC. During the year prior no significant licensing income was generated, in line with expectations.
Net sales for the "Collaborative Business" segment totalled KEUR 1,981 for the reporting year (2005: KEUR 1,936), up KEUR 45 or 2.3%. The successful processing of two long-term collaborations with Schwarz Pharma and Sanwa Kagaku Kenkyusho served to keep net sales at the previous year's level. These two collaborations account for 90% of net sales for the reporting year, consisting mainly of FTE-based payments and performance-oriented milestone payments.

4.2 Personnel costs

in KEUR	2006	2005	Change
Wages and salaries	3,027	3,018	0.3%
Social security charges	551	510	8.0%
ESOP[1]	115	41	180.5%
	3,693	**3,569**	**3.5%**

Number of employees (incl. Management Board, annual average)	55	52	5.8%

1: ESOP = Employee stock option programme for employees and Management Board

Total personnel costs during the reporting year rose in proportion with increasing staffing levels.
During the reporting year, funds accruing through salary waiver were appropriated for direct insurances for the benefit of company staff and the Management Board. These contributions are classified as defined contribution plans and are recognised and valued in accordance with IAS 19.44. Total expenditures in connection with defined contribution plans came to KEUR 66 for the reporting year (2005: KEUR 63). Of this amount, KEUR 21 (2005: KEUR 13) went to Management Board members.
Options granted to staff and Management Board members during the reporting year were reported as personnel costs in accordance with IFRS 2. Total personnel costs resulting from options granted amounted to KEUR 115 (2005: KEUR 41). Of this amount, KEUR 39 (2005: KEUR 8) went to Management Board members.
Personnel costs are recognised in the income statement under "Cost of sales", "Distribution costs", "Research and development costs" or "Administrative costs" according to their functional affiliation.

4.3 Cost of sales

in KEUR	2006	2005	Change
Personnel	302	367	- 17.7%
Commissions	118	63	87.3%
Material	103	179	- 42.5%
Miscellaneous	49	- 9	n/a
	572	**600**	**- 4.7%**

Cost of sales was largely in proportion to the development of net sales in the "Collaborative Business" segment.

4.4 Distribution costs

in KEUR	2006	2005	Change
Personnel	287	301	- 4.7%
Legal consulting and miscellaneous consulting	109	19	473.7%
Rent and ancillary costs	41	43	- 4.7%
Travel and meetings	40	40	0.0%
Miscellaneous	41	30	36.7%
	518	**433**	**19.6%**

Rising distribution costs were mainly the result of increased legal and advisory costs incurred in this area, accruing primarily in connection with the founding of QuoNova LLC. and the sale of exclusive global rights to 4SC AG's QSB substances.

4.5 Research and development costs

in KEUR	2006	2005	Change
Third-party services	2,238	820	172.9%
Personnel	2,032	1,808	12.4%
Rent and ancillary rent costs	549	639	- 14.1%
Depreciation	517	707	- 26.9%
Material	331	180	83.9%
Patents	240	200	20.0%
Software licences	117	122	- 4.1%
Miscellaneous	270	109	147.7%
Public grants (EU and BMBF)	- 586	- 326	79.8%
	5,708	**4,259**	**34.0%**

Rising research and development costs were principally due to rising costs for third-party services. 4SC AG's project in the most advanced stage SC12267 is now in phase IIa of clinical development. Two other projects (SC68896 and SC71570) are in the formal preclinical development stage. Development of the pipeline projects typically entails rising costs for third-party services such as provided by CROs. Material costs also rose substantially in consequence of project pipeline efforts. Public grants were significantly higher year-on-year, deriving from the BMBF BioChancePlus programme and two EU funding programmes. Research and development costs rose by a total of KEUR 1,449.

4.6 Administrative costs

in KEUR	2006	2005	Change
Personnel	1,072	1,092	- 1.8%
Public listing	284	1,079	- 73.7%
Rent and ancillary rent costs	245	255	- 3.9%
Legal consulting and miscellaneous consulting	195	262	- 25.6%
Depreciation	103	109	- 5.5%
Insurance and contributions	65	53	22.6%
Travel and meetings	52	27	92.6%
Miscellaneous	238	121	96.7%
	2,254	**2,998**	**- 24.8%**

Declining administrative costs resulted primarily from listing on the Frankfurt Stock Exchange in December 2005, which generated significant one-time charges incurred the year prior. During the reporting year solely post-listing costs accrued. Administrative costs thus fell by KEUR 744.

4.7 Other operating income

in KEUR	2006	2005	Change
Sublease quattro research GmbH	16	16	0.0%
Sublease Kinaxo GmbH	6	0	n/a
Release of provisions	1	11	- 90.9%
Miscellaneous	8	5	60.0%
	31	**32**	**- 3.1%**

Unused laboratory and office space is currently being subleased to quattro research GmbH and Kinaxo GmbH.

4.8 Other operating expenses

in KEUR	2006	2005	Change
Supervisory Board	95	40	137.5%
Impairment of trade receivables	65	84	- 22.6%
Monetary transactions	6	19	- 68.4%
Miscellaneous	7	4	75.0%
	173	**147**	**17.7%**

The rise in other operating expenses primarily stemmed from increasing costs in relation to the Supervisory Board.

4.9 Depreciation

in KEUR	2006	2005	Change
Depreciation	**625**	**819**	**- 23.7%**

The volume of investment during the reporting year was less than the amount necessary to offset the depreciationof fixed assets having reached the end of their useful life.
Depreciation is shown on the income statement under the categories “Distribution costs”, “Research and development costs” and ”Administrative costs”.

4.10 Financial result

in KEUR	2006	2005	Change
Loss from investments accounted for by the equity method	- 47	0	n/a
Finance income	235	267	- 12.0%
Finance expenses	- 198	- 207	- 4.3%
	- 10	**60**	**- 116.7%**

Investments accounted for by the equity method resulted in a loss of KEUR 47 (2005: KEUR 0).
See Notes on item ‘7.3. Financial assets’.
Finance income was generated through investing cash in securities and money market/interest-bearing bank accounts in the amount of KEUR 190 (2005: KEUR 37) and through valuation of securities in the amount of KEUR 37 (2005: KEUR 8).
Finance expenses primarily reflect application of the effective interest method to long-term loans totalling KEUR 82 (2005 income: KEUR 173) and interest payments to former silent partners in the amount of KEUR 35 (2005: KEUR 169).
Also included are securities sold at a loss for KEUR 64 (2005: KEUR 0) and foreign currency translation losses of KEUR 17 (2005: KEUR 0) based on balance sheet date valuation.

5. Income tax and deferred taxes

So far the company has not incurred expenses due to income taxes, having operated at a net loss since founding as it is still in an early phase of growth. The company anticipates further net losses for the next several years in accordance with its business model, profitability being a medium-term objective.
Deferred taxes claims have not been recognised thus far, the company has a history of losses and unused tax losses can only be offset against taxable income, requiring at least substantial indications that such income will be generated in corresponding amounts in the future (IAS 12.34).
The value of unused tax losses unrecognised as deferred tax asset in the balance sheet, but reportable per IAS 12.81(e) is as follows as of the balance sheet date:

in KEUR	2006-12-31	2005-12-31
Taxable losses carried forward	39,317	34,204
Effective tax rate	35.98%	34.15%
Value of taxable losses carried forward	14,146	11,681

This calculation is based on the assumption that the tax rates applicable 1 January 2007 will still apply at the time such losses are used to offset income.
Taxable losses carried forward amounts are subject to review by the tax authority. Losses may be carried forward in unlimited amount to offset future income, although some restrictions apply to offsetting. A portion of the taxable losses carried forward amount was used in the previous year to offset deferred tax liabilities as shown below.
4SC AG's sees some risk that currently existing losses carried forward may be disallowed for offsetting future profits, since the company has acquired substantial capital through numerous capital increases. 4SC AG will however petition for the admissibility of its loss carryforwards.
The determination of the effective tax rate is based on the following assumptions: taxes in Germany on income and earnings consist of corporate income tax, excise tax and the solidarity surcharge. The corporate income tax rate in Germany is a uniform 25% for distributed and retained profits. For the calculation of the deferred taxes, an effective tax rate of 26.38% was applied for corporate income tax and of 9.60% for excise tax. A base uniform tax rate of 25% applies to the corporate income tax rate with a 5.5% solidarity surcharge and factoring in excise tax deductibility at an collection rate of 300%.

Deferred tax asset and liability items shown are as follows:

	Deferred tax assets		Deferred tax liabilities	
in KEUR	**2006-12-31**	**2005-12-31**	**2006-12-31**	**2005-12-31**
Fixed assets	0	0	4	34
Securities	0	0	14	3
Long-term loans	0	0	32	59
Provisions and other current liabilities	0	0	1	3
Other current assets	6	0	0	0
Investments accounted for by the equity method	4	0	0	0
Receivables from an associate	41	0	0	0
Losses carried forward	0	99	0	0
	51	99	51	99
Balancing	- 51	- 99	- 51	- 99
	0	**0**	**0**	**0**

Differences between useful lives of fixed assets pursuant to tax law and IFRS create deferred tax liabilities. Security market valuation pursuant to IFRS also creates deferred tax liabilities. Deferred tax liabilities arise in connection with long-term loans from varying interest rates in determining present value used with these different accounting methods. Deferred tax assets in connection with receivables from associated companies are created through the application of varying discount rates.

The reconciliation between the profits tax yield and the product from the balance sheet period results and the applicable interest rate for the 4SC AG is made up as follows:

in KEUR	**2006**	**2005**
Period result before tax	- 5,540	- 6,277
Profit tax yield at a rate of 35.98% (2005: 34.15%)	- 1,993	- 2,144
Less the tax effected on deferred differences and losses carried forward for which no deferred taxes were included in the past periods	1,913	2,101
Non-deductible expenses	16	5
Permanent differences	0	23
Other differences	64	15
Profit tax yield accounted for in the income statement	**0**	**0**

6. Earnings per share

The undiluted earnings per share is calculated in accordance with IAS 33.9 et sqq from the division of the period results to which the shareholders are entitled (numerator) by the weighted average number of the shares which were in circulation in the reporting period (denominator). This is based on a share count of 11,125,067 for the reporting year and a share count of 8,187,743 for the prior year.
Since, as a result of the loss situation at 4SC AG, the convertible bonds and options that have been issued will not have a diluting effect, the diluted earnings per share correspond to the undiluted earnings per share.

in EUR	2006	2005
Earnings per share (undiluted and diluted)	**- 0.50**	**- 0.77**

7. Notes to the balance sheet

7.1 Intangible assets

Changes in intangible assets are shown under item 7.2. of the asset schedule 'Fixed Assets', in accordance with IAS 38.118. Additions during the reporting year primarily concern a patent acquired from an insolvent biotechnology firm (KEUR 71). Retirements represent discontinued software.
Assumed useful life ranges between three and fifteen years. There were no intangible assets with useful lives of assumed unlimited duration or self-created intangible assets.
Amortisation is shown on the income statement under "Distribution costs", "Research and development costs" and "Administrative costs".

Goodwill

in KEUR	2006-12-31	2005-12-31	Change
Goodwill	1,786	1,786	0.0%

The goodwill results from the merger of 4SC GmbH into 4SC AG in the year 2000, applying a fair value of KEUR 3,572. This goodwill was amortised until financial year 2004 in accordance with IAS 22.44.
The IFRS 3 and IAS 36 rules apply since financial year 2005, according to which goodwill is not amortised, but rather subject to an annual impairment test, in accordance with IFRS 3.55 and IAS 36.88 ff.
The year-end impairment test conducted indicated no need for an adjustment of the value on 31 December 2006. For the impairment test, value in use of the DHODH project was compared with the carrying value of goodwill. Value in use is primarily determined considering the following factors: the discount rate, which is the interest rate at which future cash flows are discounted to present value, the probability of market entry, a function of the phase of development the DHODH project is in, and potential market share, based on projected numbers of future treatment patients. The decision was made to forgo conducting a sensitivity test as the value in use determined was far higher than the carrying value of goodwill.

7.2 Fixed assets

Fixed assets include office equipment, laboratory equipment, miscellaneous equipment, IT-equipment and installations in third-party real property.

Changes in fixed assets are presented in the asset schedule in accordance with IAS 16.73.

Fixed assets in KEUR	Useful life up to – years	Status on 2006-01-01	Additions 2006	Retirements 2006	Status on 2006-12-31	Status on 2006-01-01	Additions 2006	Retirements 2006	Status on 2006-12-31	Status on 2006-12-31	Status on 2005-12-31
		Acquisition costs				Depreciation				Book values	
Intangible assets											
Software and patents	3 - 15	470	78	10	538	405	54	10	449	89	65
Goodwill	n/a	3,572	0	0	3,572	1,786	0	0	1,786	1,786	1,786
Intangible assets		**4,042**	**78**	**10**	**4,110**	**2,191**	**54**	**10**	**2,235**	**1,875**	**1,851**
Fixed assets											
Office equipment	8 - 14	132	5	0	137	46	11	0	57	80	86
Laboratory equipment	3 - 13	2,188	110	29	2,269	1,798	254	29	2,023	246	390
Low-value assets	n/a	0	21	21	0	0	21	21	0	0	0
Installation in third-party real property	5 - 14	946	0	0	946	262	76	0	338	608	684
Miscellaneous equipment	3 - 13	118	53	0	171	52	17	0	69	102	66
IT-equipment	3 - 7	1,429	110	34	1,505	1,152	192	33	1,311	194	277
Fixed assets		**4,813**	**299**	**84**	**5,028**	**3,310**	**571**	**83**	**3,798**	**1,230**	**1,503**
Total capital assets		**8,855**	**377**	**94**	**9,138**	**5,501**	**625**	**93**	**6,033**	**3,105**	**3,354**

Changes in fixed assets during the previous year are presented in the following asset schedule:

Fixed assets in KEUR	Useful life up to – years	Status on 2005-01-01	Additions 2005	Retirements 2005	Status on 2005-12-31	Status on 2005-01-01	Additions 2005	Retirements 2005	Status on 2005-12-31	Status on 2005-12-31	Status on 2004-12-31
		Acquisition costs				Depreciation				Book values	
Intangible assets											
Software	3 - 5	476	33	39	470	365	79	39	405	65	111
Goodwill	n/a	3,572	0	0	3,572	1,786	0	0	1,786	1,786	1,786
Intangible assets		**4,048**	**33**	**39**	**4,042**	**2,151**	**79**	**39**	**2,191**	**1,851**	**1,897**
Fixed assets											
Office equipment	8 - 14	131	1	0	132	35	11	0	46	86	96
Laboratory equipment	4 - 13	2,152	38	2	2,188	1,402	398	2	1,798	390	750
Low-value assets	n/a	2	5	2	5	2	5	2	5	0	0
Installation in third-party real property	5 - 14	946	0	0	946	186	76	0	262	684	760
Miscellaneous equipment	5 - 13	116	2	0	118	39	13	0	52	66	77
IT-equipment	3 - 7	1,468	30	69	1,429	980	237	65	1,152	277	488
Fixed assets		**4,815**	**76**	**73**	**4,818**	**2,644**	**740**	**69**	**3,315**	**1,503**	**2,171**
Total capital assets		**8,863**	**109**	**112**	**8,860**	**4,795**	**819**	**108**	**5,506**	**3,354**	**4,068**

Additions during the reporting year primarily concern a mass spectrometer (KEUR 49), expansion of the computer cluster (KEUR 45) and a new facility access control system (KEUR 34). Other purchases included workstation PCs, printers and notebooks (KEUR 32). The majority of funds invested went for replacement purposes, since the company is technologically well equipped at this time.

Depreciation of fixed assets is shown on the income statement under “Distribution costs”, “Research and development costs” and ”Administrative costs”.

7.3 Investments accounted for by the equity method

Shares held in QuoNova LLC. and quattro research GmbH are recognised as financial assets.

4SC AG sold its exclusive global rights to its QSB substances to QuoNova LLC. on 28 December 2006. In addition to the sale proceeds 4SC AG also received a share in QuoNova LLC. amounting to a 10% direct holding. This share is valued at KEUR 51 (2005: KEUR 0).
During the reporting year QuoNova LLC. posted a net loss of KEUR - 469 on net sales of KEUR 0. The proportionate net loss contributable to 4SC AG of KEUR - 47 is shown as a loss from investments accounted for by the equity method under financial results. QuoNova LLC. holds liabilities totalling KEUR 1,621, with a balance sheet total KEUR 3,679. As QuoNova LLC. was only established in 2006, no comparable figures from 2005 are available.

Quattro research GmbH posted a period result of KEUR 51 (2005: KEUR 11) for the reporting year on net sales of KEUR 522 (2005: KEUR 367). quattro research GmbH holds liabilities totalling KEUR 188 (2005: KEUR 222), with a balance sheet total of KEUR 268 (2005: KEUR 251).
The carrying value of this investment was not adjusted for the amount of period result attributable to 4SC AG of KEUR 25 because of KEUR 99 in offsetting interim profits pursuant to IAS 28.22 from financial year 2004 from the sale of a software package to quattro research GmbH. According to IAS 28.22, profit from downstream transactions with associates is only to be adjusted by amounts attributable to third parties. As third-party share in quattro research GmbH totals 51.2%, only KEUR 220 of the sales proceeds would have been reportable as income. Because offsetting the full amount of these interim profits would have implied a negative asset value, the remaining interim profits of KEUR 94 from this transaction were carried forward to the reporting year. This leaves a remaining KEUR 69 in interim profits to be offset after adjustment for the period result of quattro research GmbH of KEUR 25.
As a result of the above, the equity stake in quattro research GmbH is reportable as a long-term asset valued at KEUR 0 (2005: KEUR 0).

7.4 Receivables from associated companies

This balance sheet item reflects receivables from QuoNova LLC. and quattro research GmbH.

Receivables totalling KEUR 1,304 (2005: KEUR 0) from QuoNova LLC. are shown in connection with the sale of exclusive global rights to 4SC AG's QSB substances. This amount, nominally valued at USD 2,000, is being remitted in annual instalments in accordance with a repayment schedule. Interest is not being charged on this amount, which is recognised at present value. The risk-adjusted discounting rate is 11.0%. The short and long-term elements of these receivables are shown separately. At year-end the long-term portion amounted to KEUR 923 (2005: KEUR 0). Also shown under short-term accounts receivable is KEUR 103 invoiced to QuoNova LLC. by 4SC AG in connection with an FTE-based agreement for performing research services (2005: KEUR 0).
A total of KEUR 132 is shown representing accounts receivable from quattro research GmbH from sale of a software package (2005: KEUR 183). Interest is charged on this account at a rate of 6.0% p.a. Interest payments are to be remitted on an annual basis. This account is being resolved in instalments in accordance with a payment schedule effective through the year 2010. As this account is repayable in several annual instalments, its short and long-term portions of are shown separately. The long-term portion amounted to KEUR 98 as of financial year-end (2005: KEUR 162).

7.5 Inventories

in KEUR	2006-12-31	2005-12-31	Change
Consumable materials	14	11	27.3%
Solvents	3	3	0.0%
	17	**14**	**21.4%**

7.6 Trade receivables

in KEUR	2006-12-31	2005-12-31	Change
Domestic	134	153	- 12.4%
Third countries	0	52	- 100.0%
	134	**205**	**- 34.6%**

Trade receivables were adjusted for an impairment in the amount of KEUR 65 (2005: KEUR 84), in accordance with IAS 39.63 f.
Payments for outstanding trade receivables were received on time in January 2007 with few exceptions.

7.7 Cash

in KEUR	2006-12-31	2005-12-31	Change
Bank balances	463	366	26.5%
Cash	1	2	- 50.0%
	464	**368**	**26.1%**

Bank balances are invested in money market and similar vehicles.

The balance sheet items ‘Cash’ and parts of ‘Securities’ comprise the liquid funds shown on the cash flow statement.

7.8 Securities

in KEUR	2005-12-31	Sale/Purchase (balanced) 2006	Loss resulting from disposal 2006	Income resulting from valuation 2006	2006-12-31
Securities	6,510	- 2,476	- 64	37	4,007

Securities are classified as 'at fair value through profit or loss' in accordance with IAS 39.9. They serve the interest-bearing investment of current liquidity reserves.
Interest income of KEUR 168 (2005: KEUR 0) was generated during the reporting year, shown under Financial Result, in addition to the abovementioned income from valuation and losses from disposals reported as of the balance sheet date.
Cash inflows from the December 2005 stock exchange listing and 11 May 2006 capital increase were primarily invested in money market funds and in short-term, high-rated fixed and variable interest securities.
The securities shown on the balance sheet are thus not subject to any material interest rate, default or liquidity risks. Additional information on 4SC AG practises for addressing risks associated with financial instruments and on risk management objectives, methods and procedures established and implemented by 4SC AG Management are outlined in the management report under item '3.5. Handling of financial instruments' and '3.1. Risk management and internal control system'.
Securities of a maximum three months in duration and cash comprise the liquid funds shown on the cash flow statement.

7.9 Other current assets

in KEUR	2006-12-31	2005-12-31	Change
Tax refund claims	177	108	63.9%
Rent security deposit IZB West	157	157	0.0%
BMBF grants	115	102	12.7%
EU grants	91	0	n/a
Others	10	7	42.9%
	550	**374**	**47.1%**

There are currently no known circumstances giving rise to concerns regarding remittance of grant funding. Tenant security deposit amounts are deposited to the security deposit account.

7.10 Prepaid expenses and accrued income

Prepaid expenses and accrued income totalling KEUR 106 (2005: KEUR 236) primarily consists of pre-paid invoices for third-party scientific services, maintenance contracts, training and licenses.

7.11 Equity

7.11.1 Share capital and shares

4SC AG share capital currently totals EUR 11,461,365, consisting of 11,461,365 individual zero par common bearer shares. Each share represents EUR 1.00 of 4SC AG share capital, entailing one vote at the shareholders' meeting. Share capital is fully paid-in at this time.
4SC AG shares are securitised under three global non-coupon certificates held in custody by Clearstream Banking AG, Frankfurt am Main, a central securities depository. Shareholder right to issuance of individual certificates are excluded pursuant to Section 6, paragraph 3 of the Articles of Association.
Changes in share capital during the reporting year were as follows, impacted by the 11 May 2006 share offering.

At the start of the financial year, company share capital totalled EUR 10,530,077.

On 11 May 2006 the 4SC AG Management Board voted to issue shares from approved capital valued at a nominal EUR 931,288, with Supervisory Board approval. Shareholder subscription rights pursuant to Section 203, paragraph 1 and Section 186, paragraph 3, sentence 4, Stock Corporation Act (AktG) were excluded. 4SC AG issued 931,288 shares at a price of EUR 4.65, the majority of which were placed with institutional investors. This capital increase was recorded in the Commercial Register on 18 May 2006. The new shares are endowed with profit-sharing rights starting 1 January 2006.
4SC AG share capital increased accordingly to EUR 11,461,365.

7.11.2 Conditional capital

Company shareholders voted on 1 March 2001, 28 July 2004 and 28 June 2006 to approve increases in company share capital on a contingent basis as follows:

Conditional capital	Amount (KEUR)	Shareholder resolution date	Purpose
I	229	2001-03-01 / 2006-06-28	Exercise of "ESOP 2001" options held by company employees and held by company employees and Management Board members
II	200	2006-06-28	Granting of options to company employees and Management Board members expiring in ten years or less ("ERSATZ- ESOP 2001")
III	106	2004-07-28 / 2006-06-28	Exercise of "ESOP 2004" options held by company employees and Management Board members
IV	340	2006-06-28	Granting of options to company employees and Management Board members expiring in ten years or less ("ESOP 2006")
V	4,000	2006-06-28	Providing shares to subscribers of convertible bonds and/or warrants to be issued

7.11.3 Approved capital

At the 28 June 2006 shareholders' meeting, the Management Board was authorised to increase company share capital through one or more share offerings until 27 June 2011, subject to Supervisory Board approval, up to a total EUR 5,730,682.00 in return for cash or noncash consideration for a maximum 5,730,682 new individual bearer shares (Approved Capital I). New shares issued are to be placed with banks and other firms per Section 186, paragraph 5, sentence 1 AktG with the obligation to offer them for shareholder subscription. The Management Board is authorised however to exclude certain limited amounts from shareholder subscription, subject to Supervisory Board approval. The Management Board is furthermore authorised, subject to Supervisory Board approval, to exclude shareholder subscription rights for a maximum 1,146,136 new shares offerable versus cash to be priced shortly before placement not substantially lower than the market price of company shares already trading on the secondary market. This amount is to include shares obtained through the exercise of convertible bonds and warrants issued after granting of this authorisation on the basis of authorisation granted simultaneous with this or a substitute authorisation as per Section 186 paragraph 3, sentence 4, AktG, excluding subscription rights. The Management Board is furthermore authorised to exclude shareholder subscription rights for the issuance of a maximum 2,865,341 new shares offerable versus noncash consideration for the purpose of acquiring (directly or indirectly) companies, company divisions, shares in other companies or assets of other companies in return for company shares, subject to Supervisory Board approval. The Management Board is authorised to determine further specifics concerning shares issued from Approved Capital I, subject to Supervisory Board approval. The Supervisory Board is authorised to amend the company Articles of Association following the issuance of shares from Approved Capital I and to adjust equity capital issuance limits pursuant to Approved Capital I upon expiration of the authorisation period.

7.11.4 Additional paid-in capital

The additional paid-in capital consists of three components. Firstly, it consists of premiums that were deposited by shareholders at the time of implementation of capital increases within the framework of financing rounds.
The second component is the equity capital shares in connection with the issuance of convertible bonds.
In addition, the amount of the options issued to employees and the management board during the reporting year and during previous years in accordance with the provisions of IFRS 2 are shown in the additional paid-in capital.
The determination is explained in "9. Stock option programme".

7.11.5 Appropriation of results

The balance sheet loss of KEUR 20,281 was carried forward to the new statement.

7.11.6 Transaction costs for the issuance of equity

Transaction costs in connection with the issuance of equity are to be subtracted from shareholder's equity reduced by the amount of any applicable income tax benefits pursuant to IAS 32.35. Transaction costs of KEUR 210 accrued in connection with the 11 May 2006 capital increase. These costs were charged against additional paid-in capital.

7.12 Long-term loans

In the year prior, a KEUR 690 silent partner participation held by Technofonds Bayern, Munich, was converted into a 5.0% non-current loan, interest charged quarterly, due 31 December 2008, with an early repayment option for 4SC AG. The present value repayable amount shown was determined by applying a market interest rate of 11.0% p.a., as the actual interest rate is not in line with current market rates.
The KEUR 230 end remuneration claim due to Technofonds Bayern was converted into an interest-free loan in deferral through 31 December 2008. The present value repayable amount shown was determined by applying a market interest rate of 11.0% p.a., as the actual interest rate is not in line with current market rates either.

7.13 Provisions and deferred liabilities

Provisions and deferred liabilities for the reporting year broke down as follows:

in KEUR	2005-12-31	Consumption	Release	Allocation	2006-12-31
Outstanding invoices	78	63	0	215	230
Bonus to the Management Board	97	97	0	119	119
Supervisory Board remuneration	37	30	7	90	90
Renovation IZB West	53	0	5	0	48
Financial statement and audit costs	70	70	0	46	46
Professional association dues	19	18	1	23	23
Employee bonus	26	26	0	4	4
Miscellaneous	8	8	0	4	4
Public listing commision	397	397	0	0	0
	785	**709**	**13**	**501**	**564**

Provisions for renovation costs were created in consequence of the lease expiring 2011. The present value of the payment obligation is shown as this item is non-current.
All other provisions are current. There were no third-party reimbursement claims. Outstanding invoices (primarily representing contracted services not yet billed) reflect uncertainty to a minor extent as to actual billable amounts.

7.14 Other financial obligations

Other financial obligations for the years subsequent to the balance sheet date include facilities and office space leased by 4SC AG under a contract expiring 31 December 2011 as well as financial obligations arising from usage and research services agreements.

Future payments due pursuant to these agreements break down as follows:

in KEUR	
2007	1,448
2008	702
2009	689
2010	719
2011	749
	4,307

Expenses reportable on the income statement in connection with the lease agreement totalled KEUR 744 for the reporting year (2005: KEUR 787). This decline resulted from lower advance payments for ancillary cost and a reimbursement of ancillary costs of KEUR 81 for 2005 determined in the annual settlement of accounts.

7.15 Trade payables

in KEUR	2006-12-31	2005-12-31	Change
Domestic	439	242	81.4%
EU	45	20	125.0%
Third countries	15	9	66.7%
	499	**271**	**84.1%**

Trade payables rose as of balance sheet date.

7.16 Accounts payable to associated companies

Two agreements were signed with quattro research GmbH, Planegg-Martinsried, on the development, servicing and maintenance of software and servicing and maintenance of 4SC AG IT infrastructure and databases. The amount of KEUR 29 owed quattro research GmbH, Planegg-Martinsried pursuant to annual invoicing is shown (2005: KEUR 29).

7.17 Down payments received

This account shows down payments of KEUR 37 received in connection with an EU-funded project (2005: KEUR 0).

7.18. Other current liabilities

in KEUR	2006-12-31	2005-12-31	Change
Holiday	81	48	68.8%
Social security charges	70	48	45.8%
Miscellaneous	9	12	- 25.0%
Taxes	0	145	- 100.0%
	160	**253**	**- 36.8%**

8. Notes to the cash flow statement

8.1 Cash flows from operating activities

Cash outflows from operating activities totalled KEUR 6,150 for the reporting year (2005: KEUR 5,725), a 7.4% increase versus financial year 2005. This resulted mainly from two contrary effects. The period result before taxes for the reporting year improved 11.7% to KEUR - 5,540, while receivables from associated companies rose by KEUR 1,356 (2005: down KEUR 35). The latter reflects income from the sale of exclusive global rights to QSB substances to QuoNova LLC. only being liquidity-related in future years.

8.2 Cash flows from investing activities

Cash flows from investing activities totalled KEUR - 2,326 for the year under review (2005: KEUR 108). Funds raised through the December 2005 stock exchange listing totalling KEUR 1,949 (2005: KEUR 0) were invested during the reporting year in fixed and variable interest, high-rated securities. Investments in fixed assets and intangible assets during the reporting year primarily concerned the patent acquired from an insolvent biotechnology company (KEUR 71), a mass spectrometer (KEUR 49), expansion of the computer cluster (KEUR 45), and a new facility access control system (KEUR 34). Other purchases included workstation PCs, printers and notebooks (KEUR 32). The majority of funds invested went for replacement purposes, the company being technologically well equipped at this time. Purchase of a direct 10% equity stake in QuoNova LLC. did not precipitate cash outflows.

8.3 Cash flows from financing activities

Cash inflows from financing activities for the reporting year totalled KEUR 4,120 (2005: KEUR 10,653), a 61.3% decrease versus financial year 2005. These inflows represented exclusively the funds raised in the 11 May 2006 capital increase, in which 931,288 4SC AG shares priced at EUR 4.65 were placed primarily with institutional investors. Transaction costs of KEUR 210 were charged against the resulting directly attributable cash inflow of KEUR 4,330.

9. Stock option programme

The table below provides an overview of stock option programmes and tranches and exercise terms thus far issued:

ESOP (k/KEUR)	Tranche	Expenditure	Exercising price (EUR)	Subscription ratio[1]	issued	outstanding 2006-01-01	forfeited 2006	exercised 2006	outstanding 2006-12-31	exercisable 2006-12-31	present value	cum. PA[2]	PC 2006[3]
ESOP 2001	2001/1	01-03-31	9.60	2:1	74	59	42	0	17	17	n/a	0	0
ESOP 2001	2001/2	01-10-10	9.60	2:1	110	90	90	0	0	0	n/a	0	0
ESOP 2001	2002	02-06-30	12.00	2:1	120	75	57	0	18	14	n/a	0	0
ESOP 2001	2003	03-09-30	5.08	2:1	318	233	162	0	71	35	0.74	109	18
ESOP 2004	2004	04-09-30	4.24	2:1	122	95	4	0	91	0	0.72	61	20
ESOP 2004	2005	05-09-30	4.24	2:1	93	91	4	0	87	0	0.71	52	15
ESOP 2004	2006/1	06-05-30	4.53	2:1	26	0	0	0	26	0	0.74	17	3
ESOP 2006	2006/2	06-08-25	3.80	1:1	296	0	1	0	295	0	1.71	377	36
ERSATZ-ESOP 2001	2006/3	06-08-25	3.80	1:1	166	0	0	0	166	0	1.54	207	23
Total					**1,325**	**643**	**360**	**0**	**771**	**66**		**823**	**115**

1: For the tranches affected by the capital reduction in December 2004, the subscription ratio ist 2:1
2: cum. PC = cumulative personnel costs through the end of the vesting period
3: PC 2006 = Personnel costs for 2006

All option tranches issued are exercisable only in return for stock shares. Approved Capital provisions I through IV were adopted to fulfil the exercise of options issued.
Tranches issued between 2001 and 30 May 2006 have a term of seven years. Half of these options may be exercised a minimum three years after the issue date. Another 25% are exercisable one year thereafter, and the remaining 25% in another year's time thereafter. Once eligible, options may only be exercised if the share price exceeds the issue price by a minimum 20%.

Tranches issued on 25 August 2006 have a term of ten years. Half of the '2006/2' tranche of options may be exercised a minimum two years after the issue date. Another 25% are exercisable one year thereafter, and the remaining 25% in another year's time thereafter. 100% of the '2006/3' options tranche is exercisable in two years.
The weighted average remaining duration of all tranches issued is 5.84 years. The exercising prices of option tranches range from EUR 3.80 to EUR 12.00.

Below is provided a view of weighted average exercise prices:

Exercising prices (weighted; EUR)	
Outstanding options as of 2006-01-01	6.69
In 2006 new issued options	3.84
In 2006 forfeited options	7.81
Outstanding options as of 2006-12-31	4.21
Exercisable options as of 2006-12-31	7.67

All tranches issued after 30 September 2003 are valued in accordance with IFRS 2 rules. Certain assumptions must be made in determining the market value of these options. 4SC AG employs the Black/Scholes option pricing model. The following assumed parameters were applied to new options issued during the reporting year:

Tranche	**Market value (EUR)**	**Volatility**	**Risk-free interest rate**
2006/1	4.39	33.73%	3.61%
2006/2	3.95	50.95%	3.59%
2006/3	3.95	50.95%	3.55%

The market price given is the closing price of 4SC shares in Xetra trading on the Frankfurt Stock Exchange. Volatility represents the 90-day volatility of 4SC shares, the assumption being that this metric reflects actual share price fluctuation better than measures of market volatility. The risk-free interest rate is that for Bundesanleihen (German treasury bonds) of comparable duration. There are no anticipated dividend payments. All assumptions applied were valid as of the respective option issue dates.
Market values were not determined for tranches issued prior to 7 November 2002, as these were not subject to IFRS 2 rules. Accordingly, no personnel expenses have been computed for these tranches.

10. Related party disclosures

Total Supervisory Board remuneration for the reporting year came to KEUR 662 (2005: KEUR 688). Of this amount, KEUR 21 (2005: KEUR 13) represents contributions to defined contribution plans according to IAS 19.7. Prorated personnel costs attributable to options included in overall remuneration totalled KEUR 39 for the reporting year (2005: KEUR 8). The 261,500 share options issued to Management Board members during the reporting year were valued at KEUR 411 in accordance with IFRS 2. The resulting personnel expenses are allocated over the vesting periods of the different tranches.

Individual Management Board member remuneration for the reporting year broke down as follows:

Remuneration 2006 in KEUR	**Fixed**	**Bonus**	**Options acc. IFRS 2**	**Total**
Dr Ulrich Dauer (speaker)	132	34	6	172
Dr Daniel Vitt	115	34	6	155
Dr Gerhard Keilhauer	134	26	11	171
Dipl.-Kfm. Enno Spillner	122	26	16	164
	503	**120**	**39**	**662**

Share property 2006-12-31 Quantity	**Shares**	**Options total**	**Options of 2006**	**Options exercised in 2006**	**Max. number of subscribable shares**
Dr Ulrich Dauer	399,792	40,600	31,000	0	35,800
Dr Daniel Vitt	393,503	40,600	31,000	0	35,800
Dr Gerhard Keilhauer	9,025	71,500	61,900	0	66,700
Dipl.-Kfm. Enno Spillner	6,666	138,000	137,600	0	124,800
	808,986	**290,700**	**261,500**	**0**	**263,100**
Chairman of the Supervisory Board:					
Dr Jörg Neermann	1,500	0	0	0	0
Former Management Board member:					
Dr Stefan Busemann	296,691[1]	27,600	0	0	13,800

1: estimated value according last information in 2005. No current value known.

Dipl.-Kfm. Enno Spillner has been Supervisory Board Vice-Chairman for Concentro AG (formerly Fairvest AG) of Nuremberg since May 2002.

Total Supervisory Board remuneration for the reporting year came to KEUR 90 (2005: KEUR 37).
Individual Supervisory Board member remuneration for the reporting year breaks down as follows:

in KEUR

current members	**Profession**	**Remuneration 2006**
Dr Jörg Neermann (Chairman)	Partner	20
Dr Robert O'Connell (Vice-Chairman)	Consultant	20
Dr Brian Morgan	Principal	20
Dr Manfred Rüdiger	CEO	15
Dr Clemens Doppler	Director/Partner	0
Stefan Meißner	Executive Director	15
		90

Supervisory Board member Dr Clemens Doppler has waived remuneration of KEUR 15 accruing to him for financial year 2006.

As of the balance sheet date, Supervisory Board members sat on the following external Management/Supervisory Boards:

Dr Jörg Neermann:
- Supervisory Board Vice-Chairman for Probiodrug AG, Halle/Saale, since May 2002
- Advisory Board member at Avontec GmbH, Planegg, since September 2005
- Supervisory Board Vice-Chairman for KeyNeurotek AG, Magdeburg, since November 2005
- Director and shareholder of Kaneas Capital GmbH, Munich, since July 2006

Dr Robert O'Connell:
- Non-executive Chairman of Scottish Prudential Investment Association Ltd., Dorset, United Kingdom
- Non-executive Chairman of Forelle Estates Holdings Ltd., Dorset, United Kingdom

Dr Brian Morgan:
- Supervisory Board member, Protaffin AG, Graz, Austria
- Non-executive Director, Scottish Biomedical Ltd., Glasgow, United Kingdom
- Chairman of Board of Governors of Belmont School (Feldmore) Educational Trust Ltd., Holmbury, United Kingdom

Dr Clemens Doppler:
- Supervisory Board Vice-Chairman, Sensovation AG, Stockach
- Supervisory Board member, Micromet AG, Munich
- Supervisory Board member, Combinature AG, Berlin
- Supervisory Board member, Merlion Pharmaceuticals Inc., Singapore

In 2006, 4SC AG signed an engagement letter with Conrad Hinrich Donner Bank, Hamburg for the May 2006 4SC AG capital increase on the Frankfurt Stock Exchange. A director at Conrad Hinrich Donner Bank, Hamburg, Marcus Vitt, is brother of 4SC AG's CSO, Dr Daniel Vitt.

Relations with the affiliated company quattro research GmbH, Planegg-Martinsried, are outlined under items '7.3 Investments accounted for by the equity method, '7.4 Receivables from associated companies' and '7.16 Accounts payable to associated companies'.

Relations with the affiliated company QuoNova LLC., Melbourne, Florida, USA, are outlined under items '7.3 Investments accounted for by the equity method' and '7.4 Receivables from associated companies'.

11. Corporate governance

In their declaration of conformity as of 21 March 2006 the Management and Supervisory Boards declare in accordance with Section 161, AktG the company's full conformity with the recommendations issued by the Government Commission on the German Corporate Governance Code, announced by the Federal Ministry of Justice, with the exceptions noted below:

- Item 3.8, paragraph 2 of the Code: the D&O insurance policy currently in force provides for a KEUR 10 deductible per insured loss for directors and officers.
- Item 4.2.3 of the Code: The stock option programme for Management Board members does not prescribe any restrictions in relation to extraordinary, unforeseen developments.
- Item 4.2.3 of the Code: The stock option programmes currently in place are implemented on the basis of binding shareholder resolutions. These options may only be exercised upon the attainment of certain share price appreciation targets, but is not tied to other benchmarks.
- Item 5.4.7 of the Code: Supervisory Board remuneration currently does not include a performance-based, variable component.

The declaration of conformity has been posted on 21 March 2006 on the company web site www.4SC.com to provide shareholders convenient access at all times.

12. Auditor's fee – Section 285 paragraph (1) no. 17, German Commercial Code (HGB)

At the 28 June 2006 shareholders' meeting shareholders resolved to appoint KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft, Wirtschaftsprüfungsgesellschaft, Ganghofer Straße 29, D-80339 Munich, as auditor for the financial year 2006.

The auditor's fee for the financial year 2006 was EUR 64,000.00.

Other advisory services generated EUR 9,000.00 in expenses during the reporting year for analytical reviews performed for quarterly reporting.

13. Events after the balance sheet date

There were no events occurring after the balance sheet date for the financial year having a material impact on the net assets, financial or earnings situation of 4SC AG.

Auditor's report

We have issued the following unqualified auditor's report:

„Auditor's report

We have audited the individual IFRS financial statements, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the financial statements, together with the bookkeeping system, and the management report of the 4SC AG, Planegg, District of Munich, for the business year from January 1 to December 31, 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to Article 325 (2a) HGB (German Commercial Code) are the responsibility of the Company's management. Our responsibility is to express an opinion on the individual IFRS financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the individual IFRS financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to Article 325 (2a) HGB (German Commercial Code) and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with these requirements. The management report is consistent with the individual IFRS financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.
Without qualifying this opinion we refer to the discussion in section 3.4 in the management report. Therein it is disclosed that the Company's ability to continue as a going concern depends on the contribution of cash or liquid assets in the form of equity capital.

Munich, March 2, 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Wolfs	Rahn
Wirtschaftsprüfer	Wirtschaftsprüfer

Report of the Supervisory Board

The Supervisory Board advises and monitors the Management Board

The Supervisory Board, comprised of members Dr Jörg Neermann (Chairman), Dr Robert O'Connell (Vice Chairman), Dr Clemens Doppler, Dr Brian Morgan, Dr Manfred Rüdiger and Stefan Meißner, fulfilled its mission of advising the Management Board and monitoring its management performance in accordance with applicable law and the articles of association. Financial year 2006 saw a number of strategic decisions by Management which were discussed and aligned extensively with the Supervisory Board. The issues the Supervisory Board devoted particular attention to during the past financial year include:

- Capital increase without subscription rights in May 2006
- Expansion of the NFκB development project to include influenza as an indication
- Coordination of clinical development strategy for conducting phase IIa for the most advanced drug candidate SC12267 in combination with potential partnering strategies
- Further development of existing product candidates plus generation of new product candidates with an eye towards risk reduction within the project pipeline and current market requirements
- Medium and long-term strategic alignment and positioning of the company
- Potential partnering/licensing of projects with/to industry partners
- Evaluation of a potential takeover of a project by a pharmaceutical research and development partner
- Evaluation of strategic growth options and opportunities for filling the project pipeline
- Ensuring financing and operational capacity for the company
- Founding of QuoNova LLC, Melbourne, Florida, USA jointly with the American XL Tech Group, Melbourne, Florida, USA (4SC AG holding a 10% stake) and sale of correlating QSB patents, granting of an exclusive 4SC technology license for the identification of additional QSB substances and signing of a joint research and development agreement.

All decisions relevant for 4SC AG were discussed at length with the Management Board. The Management Board kept the Supervisory Board comprehensively informed in a timely manner and on an ongoing basis regarding significant changes. Urgent decisions were also discussed via teleconference as needed. The Supervisory Board was thus involved in all major decisions relevant to the company. Deviations from plans and targets were explained by the Management Board to the Supervisory Board and reviewed in the following. At every meeting the Supervisory Board reviewed management performance on the basis of reporting by the Management Board, discussing strategic business opportunities and specific topics with Management Board members. There was no occasion for conducting any additional investigation such as checking company documentation or appointing an independent expert.
Committee chairs regularly reported on committee work at Supervisory Board meetings.

Four physical meetings and four teleconferences were held in financial year 2006. The entire Management Board attended most meetings. No Supervisory Board member attended less than half of all Supervisory Board meetings during the period under review. Issues discussed in depth at every physical meeting included progress and developments pertaining to the project pipeline, collaboration partnerships, finances and administration, strategic options, the risk situation and staffing concerns.

21 March 2006:
The annual financial statements were adopted and approved for release following detailed discussion with the auditor at the 21 March 2006 financial statement meeting. Additional advance discussions took place between the auditor, the Audit Committee and the Supervisory Board Chairman in advance.
The Supervisory Board also outlined the company objectives for 2006 including investor relations strategy, discussing potential new employee stock option programmes. Additionally, the Supervisory Board Report, the Corporate Governance Report and Declaration of Conformity for financial year 2005 were adopted.

8 May 2006 (teleconference):
In a teleconference held on 8 May 2006 the Supervisory Board discussed short-term options for raising capital.

11 May 2006 (teleconference):
The 11 May 2006 teleconference concerned voting on a capital increase to be allocated from authorised capital without subscription rights and admittance of subscribers for the capital increase.

28 June 2006:
The Supervisory Board meeting held immediately following the first annual general meeting after the public listing focused on the content of the meeting, implementation specifics regarding the new employee stock option programmes and additional discussion of developmental planning for clinical phase IIa for the substance SC12267. The Supervisory Board also discussed specifics regarding appointment of a new auditor (KPMG) and voted in favour of the appointment as proposed at the general meeting.

14 August 2006 (teleconference):
In a teleconference held on 14 August 2006 participants discussed possible strategic growth options and other projects to eventually fill the pipeline.

28 August 2006 (teleconference):
The 28 August 2006 teleconference revolved around further exploration of options for filling the clinical project pipeline and strategic growth concerns. The current status of partnerships in place was also discussed.

21 September 2006:
Discussion at the 21 September 2006 Supervisory Board meeting centred on optimal preparations and ideal study design of the clinical phase IIa for the substance SC12267 and evaluated potential licensing deals and collaboration partnerships. The Board additionally discussed and voted in favour of amendments to the Management and Supervisory Board rules of internal procedure to better accord with current market and regulatory conditions.

11 December 2006:
The Supervisory Board meeting held on 11 December 2006 concerned of the definition and setting of the company objectives for 2007, the planning and adoption of the 2007 budget and the future development of 4SC's project pipeline in general. The Supervisory Board voted on further procedure regarding the potential takeover of a urology project of Schwarz Pharma AG, Monheim.

The Board also discussed a potential joint venture with the XL TechGroup in connection with a sale of the QSB patents, and the conclusion of a research and development agreement with the new joint venture under consideration. The Board also addressed tax-related issues of current relevance.

Supervisory Board members and the Supervisory Board Chairman in particular engaged in extensive discussion with the Management Board on relevant issues via channels including telephone and e-mail. The Management Board also kept the Supervisory Board members regularly updated on the status quo between meetings by providing financial reports and other information.

Supervisory Board committees work efficiently

The Supervisory Board has formed three committees: the Personnel Committee, the Audit Committee and the Business Development and Investor Relations Committee.

The Personnel Committee did not meet during the past financial year due to a lack of urgent or time-critical staffing issues to be addressed.

On 13 March 2006 the Audit Committee held a teleconference with the auditor Ernst & Young to discuss the status of the annual financial statements and the auditing process in particular and obtain information about audit procedures and focuses. Additional coordination followed at Supervisory Board meetings and teleconferences.

The Business Development and Investor Relations Committee convened for a 20 July 2006 teleconference to discuss the status of a number of potential licensing strategies, further options for filling the clinical project pipeline and technology transfer potential. These topics were rediscussed during a teleconference held on 15 September 2006, in addition to the current status of collaborative business. An additional meeting was held immediately prior to the 11 December 2006 Supervisory Board meeting to coordinate the content of potential expansion of the clinical project pipeline, licensing and partnering activities in relation to the start-up of QuoNova as well as the status of cooperation with Schwarz Pharma.

Changes in Management and Supervisory Board membership

In financial year 2006 there were no changes in the makeup of the Management and Supervisory Boards.

Review of annual financial statements and dependency report

The auditor appointed at the annual general meeting, KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Ganghoferstraße 29, 80339 Munich, Germany, audited the annual financial statements as well as the management reports for financial year 2006 on the basis of German Commercial Code (HGB) and International Financial Reporting Standards (IFRS), providing a unqualified auditor's opinion without noting any exceptions.

The Management Board provided these financial statements and management reports on time in advance of the March 2007 meeting to the Supervisory Board. Both the Audit Committee and the Supervisory Board examined these documents carefully, discussing them in detail at the 8 March 2007 Supervisory Board meeting. The responsible auditors answered all questions posed by the Board.

Based on its own review of the annual financial statements and the recommendation of the Audit Committee, the Supervisory Board expressed its agreement with the audit results in accordance with Section 172, Stock Corporation Act (AktG). The Supervisory Board voted to approve the annual financial statements without reservation, thereby adopting them. The Supervisory Board additionally reviewed both management reports. No objections were raised.

Efficiency of Supervisory Board performance reviewed

The efficiency review of Supervisory Board activity recommended by the German Corporate Governance Code was performed using a specially prepared questionnaire completed by all Supervisory Board members immediately following the 11 December 2006 Supervisory Board meeting.

4SC AG conformance with Corporate Governance Code

The Management and Supervisory Boards declared the company to be in conformance with the German Corporate Governance Code, 12 June 2006 version, in the latest Declaration of Conformity, also adopted on 8 March 2007, with the exceptions noted therein. For additional information, please consult the Corporate Governance Report found on pages 80 through 84, also featuring a copy of the Declaration of Conformity.

Explanation to Sections 289 (4) and 315 (4) of German Commercial Code (HGB)

The Management Board provided explanatory notes on page 26 of the management report in accordance with Sections 289 (4) and 315 (4) of German Commercial Code (HGB), in particular concerning takeover-related information. Upon review, the Supervisory Board expressed its approval of these notes.

On behalf of my associates on the Supervisory Board, I would like to thank the Management Board and the entire staff for their dedication and successful efforts in financial year 2006.

Planegg-Martinsried, March 2007

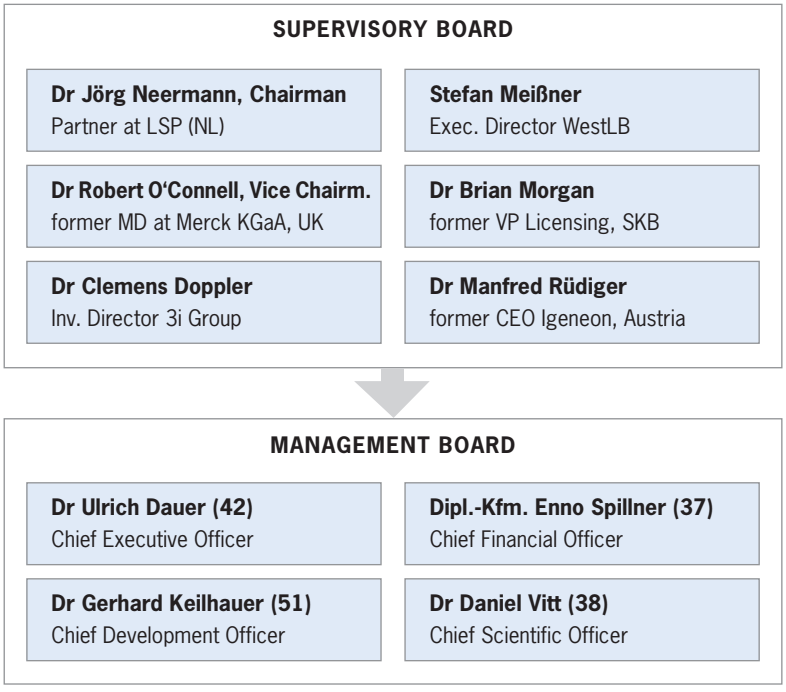
Dr Jörg Neermann
Supervisory Board Chairman

Corporate Governance Report and Remuneration Report

Close cooperation between all of the company's executive bodies, transparent communications and performance-based remuneration structures are indispensable for a young, fastgrowing company like 4SC AG. That is why the company has for many years adhered to a number of standards and regulations stipulated by the German Corporate Governance Code in its current version dated 12 June 2006. In the run up to release of the annual financial statements in January 2007, 4SC AG management took the opportunity to perform a critical reassessment of the company's compliance with the Corporate Governance Code in order to implement changes where necessary.

As a result, 4SC AG is now largely in compliance with the recommendations of the Code. The exceptions relate primarily to recommendations tailored specifically to large corporate groups that are less relevant to companies like 4SC AG.

Governance structure of 4SC AG



Shareholders and shareholders' meeting

The shareholders' meeting is one of the company's central bodies. The Management Board presents the annual financial statements to the annual general meeting. Issues voted on at the annual general meeting include the election of an auditor, the discharge of the Management and Supervisory Board, and the election of Supervisory Board members. 4SC AG pro-actively facilitates the exercise of shareholder voting rights, for example providing proxies again for the 29 June 2007 annual general meeting to vote in accordance with shareholder instructions. These individuals will also be available during the meeting.

Intensive dialogue between the Management and Supervisory Boards

The 4SC AG Management and Supervisory Boards work closely together in the interest of a sustained, long-term increase in enterprise value. The Management Board regularly coordinates the company's strategic alignment with the Supervisory Board, discussing key implementation issues. To this end, the Management Board provides regular, timely and comprehensive information to the Supervisory Board on all matters relating to planning, business development, finance, risks and risk management impacting the company. The Management Board keeps the Chairman of the Supervisory Board comprehensively informed of projects of particular importance or urgent nature to 4SC AG, even in the interim between meetings and conducting teleconferences with the relevant committees or the entire Supervisory Board respectively. Management Board rules of internal procedure provide that Supervisory Board approval is compulsory for business decisions of major significance. The Supervisory Board may additionally impose an approval requirement on specific business decisions on a case by case basis.

The Management Board team

The four-man 4SC AG Management Board is in charge of corporate leadership and responsible for achieving the objectives of steady development and increasing enterprise value over the long term. The individual members of the Management Board complement each other well in terms of their abilities and experience, running the company as a team. Individual business units are coordinated closely together, a process supported by regular Management Board meetings.

Management Board's remuneration

The annual remuneration of Management Board members consists of a non-performance-based salary, a performance-based bonus, and a long-term performance incentive in the form of stock options.

The 4SC AG Management Board received total remuneration of KEUR 662 in financial year 2006, 76% of which consisting of the fixed salary component and 24% of variable components. Bonuses are determined at the prudent discretion of the Supervisory Board based on company business results and the degree of obtainment of predefined individual and overall company goals.

The company also employs an Employee Stock Option Programme (ESOP) as a remuneration component for long-term incentive purposes, in which the Management Board and all staff members are enrolled. These stock options allow employees and Management Board members to acquire company shares. 4SC AG is convinced that such an ESOP is ideally tailored to the company. 4SC AG thus deliberately foregoes the limitation recommended by the Code for extraordinary, unforeseen developments and linking the ESOPs to benchmarks (item 4.2.3 of the Code). A positive share price development as well as meeting various performance levels is however a precondition of stock option exercise.
Detailed information is provided on pages 68 through 69 of the 2006 IFRS annual financial statements.

Present 4SC Management Board members held a total of 290,700 stock options and 808,986 shares as of 31 December 2006. Together Management Board members currently hold 7.1% of company stock.

The Supervisory Board reviews the suitability of Management Board remuneration annually. A breakdown of individual Management Board member remuneration is provided on page 70 of the Notes to the 2006 IFRS annual financial statements.
In the past financial year, the deductible for the management D&O liability insurance was KEUR 10 per loss incident. The Management Board renegotiated the deductible for financial year 2007 to a maximum USD 100,000 per loss incident, solely applicable to US claims. As D&O policy deductibles are not customary internationally, management opted for a deductible strictly for US claims.

Management Board age limit

An explicit age limit for Management Board members has not yet been set. Plans are however to comply with this Corporate Governance Code recommendation, hence the Supervisory Board voted in favour of an explicit Management Board age limit of 65 at its 8 March 2007 meeting.

Competent control and consulting by the Supervisory Board

The Supervisory Board consists of six members appointed by the shareholders at the general meeting. Dr Jörg Neermann is Board Chairman and Dr Robert O'Connell Vice Chairman; further members are Dr Clemens Doppler, Stefan Meißner, Dr Brian Morgan and Dr Manfred Rüdiger.
All 4SC AG Supervisory Board members have extensive experience in the pharmaceutical and biotechnology industries, and/or high-level corporate finance expertise in public listed companies. This ensures the Board's ability to competently control and advise the Management Board. Supervisory Board members act independently and are not affiliated with 4SC AG in terms of business or personal relations.

Supervisory Board committees
The Supervisory Board formed three committees (Audit Committee, Personnel Committee and Business Development/Investor Relations Committee) in order to leverage its own efficiency. All committees report to the overall Board about their activities.

	Supervisory Board	Audit Committee	Staffing Committee	Business Development/ Investor Relations Committee
Dr Jörg Neermann	**C**	**M**	**C**	
Dr Robert O'Connell	**Vice C**		**M**	**C**
Dr Clemens Doppler	**M**	**M**		
Dr Brian Morgan	**M**		**M**	**M**
Dr Manfred Rüdiger	**M**			**M**
Stefan Meißner	**M**	**C**		

C= Chairman / M= Member

Supervisory Board's remuneration

Total Supervisory Board remuneration for financial year 2006 came to KEUR 90. The base remuneration for Supervisory Board members for a full financial year was KEUR 10, with the Chairman of the Supervisory Board receiving twice this amount and his Deputy receiving 1.5 times this amount. The company pays KEUR 5 per committee membership. Total remuneration for any Supervisory Board member is capped at KEUR 20. 4SC AG has elected against performance-based remuneration for Supervisory Board members, at variance with the Code (item 5.4.7 of the Code).

Dr Clemens Doppler has elected to waive any remuneration for his role on the Supervisory Board.

An individual breakdown of Supervisory Board member remuneration is provided on page 71 of the Notes to the 2006 IFRS financial statements.

Supervisory Board efficiency review

The 4SC AG Supervisory Board conducted an efficiency review immediately following the Supervisory Board meeting held on 11 December 2006. All Supervisory Board members participated in this review, which was conducted using a detailed questionnaire.

The Supervisory Board came to the unanimous conclusion that its work is highly efficient, pervaded by a spirit of confidence and trust. Cooperation both within the Supervisory Board and with the Management Board was viewed very positively.
Specific proposals for improvements were discussed and are to be implemented.

The Supervisory Board intends to conduct efficiency reviews on an annual basis.

Transparent communications

4SC AG posts all information relevant to shareholders and investors on the company website (www.4SC.com) in addition to other mandatory, official channels to ensure information is provided in a timely and consistent manner. All reports are published within the periods recommended by the Corporate Governance Code and in line with stock exchange rules. Thus timely and consistent information of all shareholders is assured.

Third-party companies

A list of third-party companies is found on page 60 of the Notes to the 2006 IFRS financial statements.

Directors' dealings (reportable securities transactions)

On 16 March 2006, Dr Jörg Neermann purchased 1,500 4SC-shares at a price of EUR 4.60 per share in XETRA trading with a total deal volume of KEUR 6.9.

Management & Supervisory Board Declaration of Conformity

4SC AG places great value upon orderly Corporate Governance, viewing transparency and value-based corporate management as the norm. This is why our organisation fully implements the German Corporate Governance Code with the few exceptions outlined below, cultivating their application as part of the company's day-to-day business operations.

Declaration in accordance with Section 161 Stock Corporation Act (AktG) concerning compliance at 4SC AG with the German Corporate Governance Code in the version dated 12 June 2006

The last declaration pursuant to Section 161 AktG was issued by the Management and Supervisory Boards on 21 March 2006. This declaration was based on the 2 June 2005 version of the Code. The German Corporate Governance Code was revised in 2006; the version currently effective is dated 12 June 2006.

The 4SC AG Management and Supervisory Boards declare, pursuant to Section 161 AktG, that 4SC AG is in compliance with the recommendations issued by the government commission on the German Corporate Governance Code (12 June 2006 version) with the exceptions noted below, and that the company has maintained such compliance, barring said exceptions, since issuance of the previous Declaration of Conformity on 21 March 2006:

1) Sec. 3.8 para. 2 of the Code: The company's current D&O insurance policy only specifies a deductible on insured losses in the US to a maximum USD 100,000 per loss incident.

2) Sec. 4.2.3 para. 3 of the Code: Current stock option programmes are based on binding shareholder's meeting resolutions. Exercise of these options is permitted contingent upon share price appreciation, but not on any further benchmark parameters (such as share indices).

3) Sec. 4.2.3 para. 3 of the Code: The option programme for Management Board members does not provide for any restrictions with regard to extraordinary, unforeseeable events.

4) Sec. 5.1.2 para. 2 of the Code: In the past there has been no specific maximum age limit for Management Board members. A maximum age limit of 65 was enacted at the 8 March 2007 Supervisory Board meeting applicable to all Management Board members.

5) Sec. 5.4.7 para. 2 of the Code: There is currently no performance-based remuneration of the Supervisory Board.

Planegg-Martinsried, 8 March 2007

For the Management Board
Dr Ulrich Dauer

For the Supervisory Board
Dr Jörg Neermann

Glossar

4SCan®	Computer-based, high throughput screening technology developed by 4SC AG
Angiogenesis	The formation of tiny blood cells to provide nutrients to cancer cells
Autoimmune disease	An illness, the cause of which is a defence reaction within the immune system against the body's own tissue
Backup substance	A follow-up drug candidate with a slightly altered effective profile
BfArM	German Federal Institute for Drugs and Medical Devices (Bundesinstitut für Arzneimittel und Medizinprodukte)
BMBF	German Federal Ministry of Education and Research (Bundesministerium für Bildung und Forschung)
Clinical studies	Research trials for drug discovery (phases I through III) conducted upon human subjects and patients
CRO	Contract Research Organisation
DMARD	Disease modifying antirheumatic drugs; agents that alter the course and progression of rheumatoid arthritis
DHODH	Dihydroorotate dehydrogenase; an enzyme with an important role to play in the construction of DNA in the cell
Double-blind study	A study in which neither doctor nor patient knows whether it is the active agent or a placebo being administered
Enzyme	A protein, which makes possible or accelerates chemical reactions in the cells by acting as a catalyst
ESOP	Employee Stock Option Programme
Ethics committee	Committee commissioned with assessing ethical and legal aspects of medical research involving human subjects. Approval from the ethics committee is required prior to commencing clinical studies
FTE	Full Time Equivalent; a unit of measure denoting an amount of work deployment equal to that for one full-time employee
gram-negative	A class of bacteria with a relatively thin cell wall, which, however, cannot be penetrated by some antibiotics
H5N1 virus	Scientific designation for the avian influenza or 'bird flu' virus
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBD	Inflammatory Bowel Disease; involves recurrent or chronic inflammation in the intestinal tract
IFRS	International Financial Reporting Standards
Impairment test	Annual measurement of the value of capitalised goodwill
In silico	With the help of computers
In vitro	In the test-tube
In vivo	In the living organism
Inhibitor	A substance inhibiting a specific enzyme reaction
Ion channel	A protein which makes it possible for ions to flow through the cell membrane
Kinasis	A protein which controls cellular signal transfer
Kv1.3	A tension-dependent ion channel
Licensing out	Granting a right of use to third parties in respect of one or a number of protected rights
Metabolism	Complete set of chemical reactions that occurs in living cells
Morbus Crohn	Autoimmune disease of the intestine resulting in chronic inflammation of the intestine
Multiple myeloma	B-cell blood tumour
Multiple sclerosis	Autoimmune disease of the central nervous system which results in degeneration of the nerve sheath

NFκB	Abbreviation for "Nuclear Factor κB": a protein family, which controls various processes by activating specific genes, provoking an inflammatory reaction, for example
NSAID	Non steroidal anti inflammatory drugs; anti-inflammatory analgesic
Pathogen	Causing diseases
Pharmacokinetics	Distribution of active agents throughout the various tissues of the organism in terms of space and time
Phase I	Clinical trialling of an active agent on a small number of healthy participants carried out under strict control. Used to investigate compatibility, pharmacokinetics, form of administration and safe dosage of the active agent
Phase II	Clinical study of a small number of ill patients carried out under strict control to identify side effects and risks for an active agent appearing in the short-term. For determining the efficacy of the active agent and any defence reactions in the immune system appearing in response to the agent
Phase III	A study carried out on a large number of ill patients (a few hundred to a few thousand) to establish the safety, efficacy and optimum dosage for an active agent, under real therapeutic conditions
Placebo	A medical preparation containing no active agent
Pre-clinical study	A laboratory experiment carried out with a new drug candidate on animals, organs or cell cultures, carried out to provide evidence that a clinical study is justified and that the drug candidate can be classified as safe
Prime Standard	Listing segment of the German Stock Exchange with clearly-defined transparency requirements
Proof of concept	A milestone at which the feasibility of a project in principle is proven
Proliferation	Cell growth with inflammatory diseases and cancer
Proteasome	Multi-protein complex for the decomposition of used cellular products
Protein	A large, complex molecule composed of amino acids. Proteins are essential for the structure, regulation and function of all organisms. Typical proteins are enzymes and antibodies
Psoriasis	A skin condition characterised by scaling
QSB	Quorum Sensing Blocker; substances that influence the formation of bacterial biofilms
Rheumatoid arthritis	Autoimmune disease of the connecting tissues, principally the joints
Royalties	Payments for the use of protected intellectual property. Royalty amounts are generally calculated as a certain percentage of sales generated through use of non-proprietary intellectual property
Subject	Voluntary participants in clinical studies, generally healthy
Target	Specific biological molecule, for example an enzyme or a receptor, which plays an important role in the origination or development of a disease. Active agents/drugs bind onto target molecules, thus triggering their therapeutic activity
Toxicology	Field of medicine dealing with the effects of substances that are or can be poisonous
Toxicity	Undesirable side-effects of a substance, dependent on the dose
USPTO	United States Patent and Trademark Office
Virulence	Degree to which a causative organism can give rise to an illness

Financial calendar 2007

2007-03-29	Annual Report 2006
2007-05-10	Three Months' Report 2007
2007-06-29	Annual General Shareholders' Meeting 2007
2007-08-09	Six Months' Report 2007
2007-11-08	Nine Months' Report 2007
2007-11-12 - 2007-11-14	Analyst Meeting: Deutsches Eigenkapitalforum, Congress Center Messe Frankfurt

Imprint

Editor	4SC AG / Am Klopferspitz 19a / 82152 Planegg-Martinsried
Conception/Text	komm.passion Schumacher's AG
Design	Angela Borsche / Werbeagentur Ursula Borsche GmbH
Investor Relations	Bettina von Klitzing / E-Mail: bettina.von.klitzing@4SC.com

4SC AG | Am Klopferspitz 19a | 82152 Planegg-Martinsried | Germany
Phone 0049 (0) 89 700 763-0 | Fax 0049 (0) 89 70 07 63-29 | www.4SC.com