Final Results 2016

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Faron Pharmaceuticals Oy

29 March 2017

Faron Pharmaceuticals Ltd

("Faron" or the "Company")

Final Results for the year ended 31 December 2016

TURKU - FINLAND, 29 March 2017 Faron Pharmaceuticals Ltd ("Faron") (LON: FARN), the clinical stage biopharmaceutical company, today reports its full year audited results for the year ended 31 December 2016.

The 2016 Annual Report and Accounts become available in mid-April in digital form on the Company's website together with the invitation to the Annual General Meeting (AGM).

HIGHLIGHTS

OPERATIONAL:

Traumakine®

- Pivotal, pan-European, Phase III INTEREST trial for the treatment of Acute Respiratory Distress Syndrome ("ARDS"), has continued to progress as planned.
- Maruishi, Faron's Japanese licensing Partner, reported top line results from its Phase II safety study which indicated there were no safety concerns and, similarly to Faron's phase I/II UK study, also showed reduction of 28-day mortality.
- Initiation of Maruishi's own pivotal Phase III study in Japan which aims to recruit 120 severe and moderate ARDS patients split between treatment and placebo arms.
- Initiated filing of a clinical trial application (CTA) for the use of Traumakine in a second indication for the prevention of mortality among operated RAAA (Rupture of Abdominal

Aorta Aneurysm) patients.

- Filed patent application in Finland for the intravenous formulation of interferon-beta and received a first allowance letter from the Finnish Patent Authorities indicating potential success in Europe and USA.
- Entered into licensing agreement with Pharmbio Koreo Inc (Pharmbio) for the commercialisation of Traumakine in Korea and received a signing fee of €750,000.

Clevegen®

- Established production clones for the humanised, and de-immunised, monoclonal antibody FP-1305 with Faron's technology partner, Selexis.
- Entered into a collaboration agreement with Abzena Corp (LSE: ABZA) to establish large scale GMP manufacturing for Clevegen.
- Filed two new patent applications to seek further protection for Clevegen. If successful, Clevegen will be protected for the next 20 years.
- Expansion of Clevegen's use to include removal of local immune suppression around tumors (TIET), chronic infections (CIRT) and vaccination sites (VRET).

FINANCIAL

- Raised total equity of €9.3 million (net €8.5 million) by issuing 3,200,000 new ordinary shares at a price of 250 pence per share. The proceeds are being used to fund Traumakine US safety trials (INTRUST), Clevegen pre-clinical and clinical development to Phase I/II for lead indication of hepatocellular carcinoma (HCC) and the RAAA European clinical development to Phase II (INFORAAA trial), as well as further R&D and operational expenses.
- Generated €1.2 million (2015: €0.5 million) revenues mainly from sales of active pharmaceutical ingredient (API) and sales of medical products for trials. The €0.7 million licence agreement cash signing fee from Pharmbio was recorded as advance payment. In addition, the Company recorded grant income of €1.7 million (2015: €0.7 million) from the EU FP7 grant.
- Drew down €0.6 million of a €1.5 million R&D loan granted by Tekes in 2015 to progress the Clevegen programme.
- On 31 December 2016, the Company held cash balances of €11.5 million (2015: €11.1million).
- Operating loss for the financial year ended 31 December 2016 was €9.3 million (2015: €6.2 million loss).
- Net assets on 31 December 2016 were €10.9 million (2015: €11.2 million).

POST-PERIOD END HIGHLIGHTS

- On 9 February 2017, announced a third IDMC recommendation to continue the Phase III INTEREST trial as planned and also confirmed the expected read-out from the trial to be in H2 2017.
- On 20 February 2017, announced recruitment of the first patient in the Traumakine INFORAAA trial for the prevention of multi-organ failure and patient mortality after surgical repair of a RAAA.
- On 1 March 2017, announced the successful raise of approximately €5.8 million before expenses from the placing of 1,422,340 ordinary shares at a price of 350 pence per share.

Commenting on the results, Dr Markku Jalkanen, CEO of Faron, said:

"Faron's mission is to develop new treatments in genuine areas of unmet medical need. 2016 was an important year of progress for Faron, during which we sucessfully achieved all of the major goals set out at the time of our IPO in 2015, with a lower cash burn than anticipated. This was due, in part, to our effective use of grant funding (being non-dilutive financing) to continue our exciting development programmes. 2017 will be a pivotal year for

Faron as we await results from our Phase III INTEREST trial, which if favourable, will pave the way for the launch of our first commercial product Traumakine, for the treatment of ARDS. We also look forward to making significant progress with our exciting immune switch candidate, Clevegen, which we hope to see move into the clinic during 2017. None of this would be possible without the support of our highly motivated and skilled staff, and supportive shareholders, who I would like to thank on the behalf of the management team and Board."

For more information, please contact:

Faron Pharmaceuticals Oy
Dr Markku Jalkanen, Chief Executive Officer
investor.relations@faronpharmaceuticals.com

Consilium Strategic Communications
Mary-Jane Elliott, Chris Welsh, Lindsey Neville
Phone: +44 (0)20 3709 5700
E-mail: faron@consilium-comms.com

Westwicke Partners, IR (US)
Chris Brinzey
Phone: 01 339 970 2843
E-Mail: chris.brinzey@westwicke.com

Cairn Financial Advisers LLP, Nominated Adviser
Emma Earl, Tony Rawlinson, Rebecca Anderson
Phone: +44 207 213 0880

Panmure Gordon (UK) Limited, Joint Broker
Freddy Crossley, Duncan Monteith (Corporate Finance)
Tom Salvesen (Corporate Broking)
Phone: +44 207 886 2500

Whitman Howard Limited, Nominated Broker (UK)
Ranald McGregor-Smith, Francis North
Phone: +44 207 659 1234

About Faron Pharmaceuticals Ltd

Faron (AIM:FARN) is a clinical stage biopharmaceutical company developing novel treatments for medical conditions with significant unmet needs. The Company currently has a pipeline focusing on acute organ traumas, vascular damage and cancer immunotherapy. The Company's lead candidate Traumakine, to prevent vascular leakage and organ failures, is currently the only treatment for Acute Respiratory Distress Syndrome (ARDS) undergoing Phase III clinical trials. There is currently no approved pharmaceutical treatment for ARDS. An additional European Phase II Traumakine trial is underway for the Rupture of Abdominal Aorta Aneurysm ("RAAA"). Faron's second candidate Clevegen® is a ground breaking pre-clinical anti-Clever-1 antibody. Clevegen has the ability to switch immune suppression to immune activation in various conditions, with potential across oncology, infectious disease and vaccine development. This novel macrophage-directed immuno-oncology switch called Tumour Immunity Enabling Technology ("TIET") may be used alone or in combination with other immune checkpoint molecules for the treatment of cancer patients. Faron is based in Turku, Finland. Further information is available at www.faronpharmaceuticals.com

Annual Results Statement

Introduction

Overview of the Company

Faron is a clinical stage biopharmaceutical company developing novel treatments for medical conditions with significant unmet needs. The Company currently has a pipeline focusing on acute organ traumas, vascular damage and cancer immunotherapy.

Strategy

Faron's strategy is to maximise the potential of its pipeline of drug candidates and to progress the development of its lead product Traumakine. Faron targets several endothelial molecules involved in the maintenance of the endothelial barrier which is a thin layer or membrane of cells that lines blood and lymphatic vessels to separate blood content from tissues. The Company believes that the control of these molecules provides a unique way to treat many life-threatening conditions with high unmet medical needs. Faron collaborates with its strategic partners in research, manufacturing and drug development to bring new pharmaceutical products to market in a timely and cost-effective manner and has formed a core team of leading scientists in capillary biology and diseases arising from vascular leakage. The Company has established links with leading laboratories and clinics based at Turku University in Finland, University College London and other institutions.

To date, Faron has operated on a relatively low cost basis by employing only key members of staff and outsourcing where possible. Typically, all development work up to the proof-of-concept stage of drug development is carried out in the innovators' laboratories. The Company outsources all of its manufacturing activities in relation to its products to third parties and collaborates with Contract Research Organisations (CROs) to carry out the clinical development programmes. Faron monitors and evaluates potential commercial opportunities for its established drug candidates, such as Traumakine and Clevegen and its technologies, as and when they arise and will consider how best to crystallise as much value as possible for Shareholders, which may include holding rights in main territories for as long as it is feasible, or, in certain circumstances, up to the marketing stage.

Chairman's Statement

2016 was an important year for Faron. The highly experienced management team has made significant progress with Traumakine and Clevegen during its first full financial year following the successful AIM listing on the London Stock Exchange in November 2015.

The Company's novel therapies, Traumakine and Clevegen, have been developed from a thorough and deep scientific knowledge and understanding of endothelial barrier function and control, and both products are delivering exciting data.

Faron's lead drug candidate, Traumakine, continues to recruit patients into the pivotal, pan-European Phase III INTEREST trial, which is due to report the critical end points (e.g. mortality difference between placebo and active treatment) in the second half of 2017. We believe that Traumakine, as the only product in late stage clinical development for the treatment of ARDS, represents a significant opportunity to treat patients with this serious condition.

The Company also believes that Traumakine could have applications across other serious indications and in early 2017, recruited the first patient in a phase II trial (INFORAAA) assessing Traumakine for the prevention of Multi-Organ Failure (MOF) and patient mortality after surgical repair of a RAAA. RAAA is a medical emergency with no known treatment and an overall mortality of 30 to 50% for post-operative refusion injury for RAAA patients.

Faron's second product, its pre-clinical immunotherapy candidate, Clevegen, causes conversion of the immune environment around a tumour from immune *suppressive* to immune *stimulating* by reducing the number of tumour-associated macrophages (TAMs). Recent developments in the exciting field of cancer immunotherapy have been well documented with a number of important indications of clinical success. We believe that Clevegen is well differentiated from other immunotherapies through its specific targeting of M2 TAMs which facilitate tumour growth, while leaving intact the M1 TAMs that support immune activation against tumours. In July, we were pleased to enter an agreement with Abzena for the manufacture of Clevegen for use in primate toxicity and Phase I/II clinical studies.

The Company is well funded, having secured €9.3 million in a private placing in September 2016 and a further €5.8 million in February 2017. Both placements were executed at a premium to the Company's share price, which indicates the level of confidence our investors, both new and established, have in our products, our strategy and the ability of our management to deliver.

Faron's key focus for 2017 will be to prepare the business for the anticipated commercial launch of Traumakine in the event of a positive European Phase III data readout and prepare for the commencement of a Phase II safety trial in the US, whilst also continuing the pre-clinical and planned early-stage clinical development of Clevegen.

As ever the Board will continue to look for opportunities to deliver and enhance value to our Shareholders as well as patients who will benefit from the new drugs Faron is developing.

The Board recognises the efforts of the management team to deliver the successes achieved in 2016 and is grateful to the investigators and patients who are part of our clinical trials.

We look forward to an exciting 2017 with continued support from shareholders as we progress our exciting products, Traumakine and Clevegen.

Dr Frank M Armstrong - Chairman
March 28, 2017

Chief Executive Officer's Review and Operational Review

When Faron listed on the London Stock Exchange's AIM in November 2015, the Company had ambitions to deliver on its promises and exceed expectations. Faron has so far achieved its stated goals and with a lower than anticipated cash burn. We expect this momentum to continue into the coming year and our focus remains stronger than ever.

We have complemented our funds raised at IPO with additional successful equity finance rounds (September 2016 and February 2017) in order to expand our pipeline development to new indications and territories, as well as broadening our institutional shareholder base.

Traumakine Development

Our lead drug, Traumakine, progressed as planned to the full scale Phase III trial (INTEREST) during 2016 for the treatment of ARDS. ARDS is a severe, life-threatening medical condition characterised by widespread capillary leakage and inflammation in the lungs, most often as a result of sepsis, pneumonia or significant trauma. Currently there are no pharmacological treatments for ARDS, an orphan disease with a 30-45% mortality rate. Traumakine has been granted Orphan Drug Designation in Europe which allows a period of

10 years of market exclusivity following marketing approval by the European Medicines Agency. The Phase III INTEREST trial is being led by Professor Geoff Bellingan from University College London Hospital and Professor Marco Ranieri from the University of Rome. Subject to the successful completion of the Phase III INTEREST trial in the second half of 2017 and achievement of regulatory approvals, Traumakine will potentially be the first effective, mechanistically-targeted, disease-specific pharmacotherapy for ARDS patients and has the potential to revolutionalise intensive care practices.

To date, Faron has entered into agreements with three pharmaceutical companies to carry out the clinical development and commercialisation of Traumakine in Japan, Greater China and Korea. Faron owns the intellectual property and marketing rights in respect of Traumakine in all other territories.

Our Japanese licensing partner, Maruishi Pharmaceutical Co., Ltd announced similar positive results from its Phase II Japanese study for Traumakine. Based on these results Maruishi is now conducting a pivotal phase III trial in Japan according to the advice from the Japanese FDA (PMDA).

Faron continued out-licensing of Traumakine in Asia signing a profit sharing agreement with PharmBio, a Korean pharmaceutical company, on rights to develop and commercialise Traumakine in Korea. Faron received a signing fee of €750,000, with additional milestones and royalty payments agreed.

Parallel to completion of the European Phase III study, Faron plans to commence a Phase II US safety study (INTRUST) with Traumakine in H2 2017, which is expected to take 12 months to complete. The timing of this planned trial remains subject to regulatory approvals, with a pre-IND FDA meeting targeted to occur in mid 2017. Faron is currently in the process of establishing the trial structure and is recruiting PI's, IDMC, sites and CROs in the US.

Clevegen Development
One of Faron's key areas of focus is to develop a cancer treatment that supports the hosts' immune defences against tumours, as these are often suppressed in cancer patients. Faron's second most advanced drug development project, Clevegen, revolves around Clever-1, a cell surface molecule involved in cancer growth and spread. The active pharmaceutical ingredient of Clevegen is a humanised anti-Clever-1 antibody.

Faron has an agreement with Geneva based Selexis to prepare high yield production clones for Clevegen (FP-1305) which was successfully completed in mid 2016. In order to obtain GMP grade antibodies, Faron contracted Abzena to build a manufacturing process for Clevegen, allowing Faron to design a final primate tox study and plan human clinical studies in several cancer groups. Abzena informed the Company at the end of 2016 that the selected clones produce more than 5 g/l, which is widely considered a commercially feasible level.

During 2016, Faron has utilised €0.8 million of the €1.5 million loan funding from Tekes, the Finnish Funding Agency for Innovation, to progress the preclinical development of Clevegen. The funding is a government loan which covers 50% of the budgeted cost of the preclinical development of Clevegen.

Upcoming Newsflow
The Board anticipates the following pipeline progress during 2017:

Traumakine:

- Read-out for the pan-European phase III trial (INTEREST) results (all-cause mortality at day 28) during H2 2017.

- Advanced advice from IDMC (Independent Data Monitoring Committee) on the INTEREST study is expected in May 2017. Faron recently received the third recommendation from IDMC for the trial to continue without any modifications.
- The Company has established a manufacturing plan to build its stocks of Traumakine. Subject to a positive outcome of the INTEREST study, having manufacturing in place should facilitate the application process for market approval of Traumakine.
- The Company plans to commence a Phase II US safety study (INTRUST) with Traumakine in H2 2017. It is expected that the full study will take 12-15 months to get to D28 and D90 all cause mortality data. Timing remains subject to regulatory approvals with a pre-IND FDA meeting targeted to occur in mid 2017.
- The Company currently expects recruitment in the Japanese Phase III pivotal study for the treatment of ARDS with Traumakine, run by its Japanese licensing partner Maruishi Pharmaceutical Co., to progress towards completion during 2017.
- Interim results from the 160 patient Traumakine clinical study (INFORAAA) for the treatment of patients with rupture of acute abdominal aorta (RAAA), which began recruiting in February 2017, is expected in 12 to 18 months. The aim of this trial is to reduce mortality in operated RAAA patients, which normally varies from 30 to 50% of all patients surgically operated on. The INFORAAA study will also assist in the design of Traumakine trials for single organ failures.

Clevegen:

- Subject to access of Clevegen's active pharmaceutical incredient (FP-1305), Faron has contracted a toxicological pre-clinical study for Clevegen to start in mid 2017.
- The Company expects to file the first CTA with the UK regulatory authorities (MHRA) in late 2017 / early 2018 and this study is expected to provide enough safety data for acceptance of the CTA. The first, and primarily safety focused clinical trial is expected to be conducted with liver cancer patients at the Birmingham University Liver Cancer Centre and is expected to continue into a Phase II study via an adapted trial design for HCC patients to recognise early efficacy signals.
- The second set of clinical cancer trials will be conducted in parallel with the HCC trial in Scandinavia with melanoma, pancreas and ovarian cancer patients.

Commerical:

- Faron is exploring various commercial opportunities while continuing to develop the pipeline with the existing resources.

Financial Review

Key Performance Indicator

Faron is a late clinical stage drug development company with limited recurring sales and thus the primary Key Performance Indicators (KPIs) followed by the Board focus on cash balances and other related information. During 2016, the Company had a net increase in cash flow of €0.4 million despite significant investments in R&D. This was mainly due to successful fundraising and stronger than expected revenues and other operating income. The Board will consider the appropriateness of monitoring additional KPIs as the Company's operations advance.

Revenue and Other Operating Income

The Company's revenue was €1.2 million for the year ended 31 December 2016 (2015: €0.5 million), which comprised of sale of excess API material and sales of IMP -material. The €0.7 million licence agreement cash signing fee from Korean license partner PharmBio was recorded as advance payment. The Company also recorded €1.7 million (2015: €0.7 million) of other operational income. This comprised of income recognised from the European

Commission FP7 grant in support of the Traumakine programme as well as a grant component from public loans.

Research and development costs

The R&D costs increased by €5.6 million (141%) ftom €4.0 million to €9.6 million. This was mainly due to the INTEREST -trial which recruited its first patient very late 2015 and was in full capacity during 2016. Also Clevegen development entered into a more active phase. The third contributer to the R&D cost increase was preparatory work for eventual Traumakine launch including ramp-up of production of API.

Share-based Compensation

As part of the IPO process, a number of options were awarded to Directors and key personnel. This had no cash impact on the results for the year, however, accounting standards require this share based compensation to be recognised in the Consolidated Statement of Comprehensive Income, resulting in a charge of €0.5million (2015: €0.5 million).

Taxation

The Company's tax credit for the fiscal year 2016 can be recorded only after the Finnish tax authorities have approved the tax report and confirmed the amount of tax-deductible losses for 2016. The total amount of cumulative tax losses carried forward approved by tax authorities on 31 December 2016 was €13.9 million (2014: €5.7 million). These losses can be utilised during the years 2019 to 2025 by offsetting them against profits. In addition, Faron has €2.8 million research and development costs incurred in the financial years 2010 and 2011 that have not yet been deducted in its taxation. This amount can be deducted over an indefinite period at the Company's discretion.

Losses

Loss before income tax was €9.3 million (2015: €6.2 million). Net loss for the year was €9.2 million (2015: €6.2 million), representing a loss of €0.39 per share (2015: €0.30 per share) (adjusted for the changes in share capital).

Cash Flows

The Company was able to maintain a positive net cash inflow of €0.4 million for the year ended 31 December 2016, compared to a positive net cash inflow of €10.8 million for the previous year. Cash used for operating activities increased by €1.3 million to €8.5 million for the year, compared to €7.1 million for the year ended 31 December 2015. This increase was driven by a €5.6 million (142%) increase in research and development investments, and was offset by a €1.7 million (142%) increase in income and a €0.9 million (29%) reduction in administrative costs.

Net cash inflow from financing activities €9.0 million (2015: €18.1 million) mainly due to the receipt of net proceeds of €8.5 million from an equity placing completed in September 2016.

Financial Position

As at 31 December 2016, total cash and cash equivalents held were €11.5 million (2015: €11.1 million). This excludes the funds raised in the financing round announced on 1 March 2017.

Headcount

Average headcount of the Company for the year was 10 (2015: 6). The increase in headcount is attributable to the commencement of the Phase III INTEREST trial.

Shares and Share Capital

Using the authorisations granted at the Annual General Meeting held on 26 May 2016, on 23 September 2016, the number of ordinary shares in issue increased to 26,311,704 following the issue of 3,200,000 new ordinary shares at a subscription price of £2.50 per share. The subscription price was credited in full to the Company's reserve for invested unrestricted equity, and the share capital of the Company was not increased.

Based on a resolution of the Extraordinary General Meeting held on 15 September 2015, the Company adopted the 2015 Share Option Plan. On 21 November 2016 the Company announced that the Board of Directors had granted 400,000 options under the plan to directors, management and employees of the Company. The directors options are detailed in Directors´ Remuneration Report set out in the Annual Report and Accounts.

Money Raised to Date

To date, the Company has been funded with a total of approximately €44 million, made up of a combination of equity, debt and grant funding, which has been used to develop the Company's products and intellectual property. The Company has also generated cash revenues of €4.5 million to date through the receipt of milestone payments pursuant to certain of its licensing arrangements and the sale of surplus raw materials.

Summary and Outlook

2016 was an important year of progress for Faron during which we sucessfully achieved all of the major goals set out at the time of our IPO in 2015 with less cash burn than anticipated.

2017 will be a pivotal year for Faron as we await results from our Phase III INTEREST trial, which if favourable will pave the way for the launch of our first commercial product Traumakine, for the treatment of acute organ failures. We also look forward to making significant progress with our exciting immuno-oncology candidate, Clevegen, which we intend to progress into the clinic during 2017-18. The Board looks forward to the coming period with great confidence.

ANNUAL RESULTS

Statement of comprehensive income	Year ended 31 Dec 2016 €'000	Year ended 31 Dec 2015 €'000
Stated in Euro		
Revenue	1 153	520
Cost of sales	-	(25)
Gross profit	1 153	496
Other operating income	1 742	701
Administrative expenses	(2 161)	(3 061)
Research and development expenses	(9 592)	(3 971)
Operating result	(8 858)	(5 835)
Financial income	0	0

Financial expenses	(361)	(311)
Net financial costs	(361)	(311)
Loss before income taxes	(9 219)	(6 146)
Income tax expense	(75)	(42)
Total comprehensive income for the financial year	**(9 294)**	**(6 188)**
Total comprehensive income, attributable to:		
Equity holders of the Company	(9 294)	(6 188)
Loss per share attributable to equity holders of the Company		
Basic and diluted loss per share, euro	(0,39)	(0,30)

Balance sheet

	31 Dec 2016 €'000	31 Dec 2015 €'000
Stated in Euro		
Assets		
Non-current assets		
Property, plant and equipment	21	28
Intangible assets	933	1 001
	954	**1 029**
Current assets		
Inventories	1 451	649
Trade and other receivables	3 404	2 074
Cash and cash equivalents	11 478	11 068
	16 333	**13 791**
Total assets	**17 287**	**14 821**
Equity and liabilities		
Capital and reserves attributable to equity holders of the Company		
Share capital	2 691	2 691
Unregistered share capital	-	-
Reserve for invested non-restricted equity	34 006	24 533
Retained earnings	(25 814)	(16 046)
Total equity	**10 884**	**11 178**

Non-current liabilities		
Interest-bearing financial liabilities	2 033	1 446
	2 033	**1 446**
Current liabilities		
Interest-bearing financial liabilities	93	245
Non-interest-bearing financial liabilities	1 874	436
Other current liabilities	2 403	1 517
	4 371	**2 197**
Total liabilities	**6 404**	**3 643**
Total equity and liabilities	**17 287**	**14 821**

Statements of cash flows

	Year Ended 31 Dec 2016 €'000	Year Ended 31 Dec 2015 €'000
Stated in Euro		
Cash flow from operating activities		
Loss(-) / profit(+) attributable to equity holders of the Company	(9 294)	(6 188)
Adjustments for		
Depreciation and amortisation	168	184
Financial items	361	298
Income taxes	75	42
Non-cash items (write-off R&D)	-	78
Non-cash items (options granted)	480	474
Change in net working capital:		
Trade and other receivables	(1 330)	(2 035)
Inventories	(802)	50
Trade and other current liabilities	2 325	278
Interest and other financial costs paid	(361)	(285)
Interest and other financial income received	0	0
Income taxes paid	(75)	(42)
Net cash used in / from operating activities (A)	**(8 452)**	**(7 146)**
Cash flow from investment activities		
Investments in machinery and equipment and intangible assets	(92)	(107)
Net cash from/used in investing activities (B)	**(92)**	**(107)**
Cash flow from financing activities		
Proceeds from issue of share capital/issue	8 519	18 080
Proceeds from issue of convertible notes		
Proceeds from current borrowings	(151)	-
Proceeds from non-current borrowings	587	-
Repayment of current borrowings	-	-
Net cash used in financing activities (C)	**8 955**	**18 080**
Net increase(+) / decrease (-) in cash and cash equivalents (A+B+C)	410	10 827
Cash and cash equivalents at 1 January	11 068	242
Cash and cash equivalents at 31 December	11 478	11 068

Statement of changes in equity

In thousands of euro

	Share capital	Un-registered share capital	Reserve for invested non-restricted equity	Retained earnings	Total equity
Balance at 31 December 2014	**2 691**	**-**	**6 453**	**(10 332)**	**(1 188)**
Total comprehensive income for the financial year 2015				(6 188)	(6 188)
					-
Transactions with equity holders of the Company					-
Share base payment				474	474
Increase of share capital		-	19 261	-	19 261
Transaction costs on share capital issued			(1 181)		(1 181)
Conversion of convertible notes		-		-	-
	-	-	18 080	(5 714)	12 366
Balance at 31 December 2015	**2 691**	**-**	**24 533**	**(16 046)**	**11 178**
Total comprehensive income for the financial year 2016				(9 294)	(9 294)
					-
Transactions with equity holders of the Company					-
Share base payment				480	480
Increase of share capital		-	9 330	-	9 330
Transaction costs on share capital issued			(811)		(811)
Conversion of convertible notes		-		-	-
	-	-	8 519	(8 814)	(295)
Balance at 31 December 2016	**2 691**	**-**	**33 052**	**(24 860)**	**10 884**

NOTES TO THE ANNUAL RESULTS
For the year ended 31 December 2016

Note 1 Basis of preparation

The audited financial information set out herein does not constitute statutory accounts as defined in Finnish Accounting Act. The financial information presented here for the year

ended 31 December 2016 has been extracted from the Group's audited financial statements which were approved by the Board of Directors on 28 March 2017 and which are available on the Company's website.

These are Faron's third full year financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (and as published by the International Accounting Standards Board (IASB) and in force as at 31 December 2016. In the EU IFRS are standards and their interpretations adopted in accordance with the procedure laid down in regulation (EC) No 1606/2002 of the European Parliament and of the Council. Faron has consistently applied these policies to all the years presented, unless otherwise stated. The Company has not applied any standard, interpretation or amendment thereto before its effective date.

Faron's date of transition to IFRS is 1 January 2014. The Company has applied IFRS 1 *First-time Adoption of International Financial Reporting Standards* in preparing these financial statements. Until 31 December 2013 Faron's separate financial statements have been prepared in accordance with Finnish Accounting Standards (FAS).

The financial statements are prepared under the historical cost convention, except as disclosed in the accounting policies below.

The financial year of Faron is the calendar year ending 31 December. The figures in the financial statements are presented in thousands of euro unless otherwise stated. All figures presented have been rounded, and consequently the sum of individual figures may deviate from the presented aggregate figure.

The Company has not had any other comprehensive income in those years presented in these financial statements.

Faron's financial statements are prepared on a going concern basis. It is the intention of the Company to continue the development of the products to the point where they can be either licensed at attractive terms to internationally active pharmaceutical companies who have the means to further develop these products, or to develop the products in-house until receipt of marketing approval from the relevant regulatory agencies. After such approval, Faron would either seek to form partnerships with global, regional or local pharmaceutical companies that have the necessary marketing and distribution capabilities and resources or take the approved product to the markets itself. In the case of partnership, Faron would typically grant geographically limited licenses to products in exchange for contractually agreed payments, license fees and royalties on future product sales. In some cases, one element of such agreements may include a collaboration in which Faron will also receive funding for R&D services provided at a cost plus basis. In case of choosing to market the product itself, Faron would need to secure necessary funding to cover the costs of taking the product through the approval, pricing and regional registering process in addition to required marketing costs. In absence of collaboration agreement such funding would mainly come in form of equity funding.

In addition to its normal R&D and corporate activities, Faron seeks, as a clinical stage drug discovery and development company, to advance the development of its lead compounds through clinical trials. The Company conducts these either together with development partners or by itself. In both cases these activities require substantial amounts of funds.

Faron primarily relies upon financing its activities through equity financing, license agreements, and public R&D loans and grants.

The preparation of financial statements under IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the end of the reporting period as well as the reported amounts of income and expenses during the reporting period. These estimates and assumptions are based on historical experience and other justified assumptions that are believed to be reasonable under the circumstances at the end of the reporting period and the time when they were made. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis and when preparing financial statements. Changes in accounting estimates may be necessary if there are changes in the circumstances on which the estimate was based, or as a result of new information or more experience. Such changes are recognised in the period in which the estimate is revised.

Note 2 Share Based Payments

Share-based incentive programmes under which board members and employees have the option to purchase shares in the Company (equity-settled share-based payment arrangements) are measured at the equity instrument's fair value at the grant date.

The cost of equity-settled transactions is determined by the fair value at the date of grant using the Black-Scholes valuation model. The cost is recognised together with a corresponding increase in equity over the period in which the performance and service conditions are fulfilled, the vesting period. The fair value determined at the grant date of the equity-settled share-based payment is expensed on a straight line basis. No expense is recognised for grants that do not ultimately vest.

See Note 13 for more details.

Note 3 Intangible assets

Faron's intangible assets include patents and internally developed intellectual property ("documentation-related assets"). An intangible asset is recognised only if it is probable that the future economic benefits attributable to the asset will flow to Faron and the cost of the asset can be measured reliably. All other expenditure is expensed as incurred. These intangible assets are initially recognised at cost. Cost comprises the purchase price and all costs directly attributable to bringing the asset ready for its intended use. Subsequently intangible assets are carried at cost less amortisation and any accumulated impairment losses.

Internally generated intangible assets arising from development are recognised if, and only if, all the criteria for recognition are fulfilled:

- it is technically feasible to complete the intangible asset so that it will be available for use;
- there is an ability to use or sell the intangible asset;

- it can be demonstrated how the intangible asset will generate probable future economic benefits,adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and
- the expenditure attributable to the intangible asset during its development can be reliably measured.

The internally developed documentation asset is related to the re-development of the active pharmaceutical ingredient, ("API") ("API documentation"). The development activities and documentation relate to stability testing of a drug substance, that is sellable as such, but the usage value of which improves as the prolonged stability is proven and documented. In addition to its own use, Faron may also, for a fee, license the documentation to companies that can utilise documentation in their own drug candidate approval and registration documentation. Provision of such access does in no way limit Faron's ability to use the documentation in its own application processes or ability to give such access to additional users.

Intangible assets are amortised over their expected or known useful lives on a straight-line basis beginning from the point they are available for use. The estimated useful life is the lower of the legal duration and the economic useful life. The estimated useful lives of intangible assets are regularly reviewed. The estimated useful life for intangible assets is currently 10 years. The effect of any adjustment to useful lives is recognised prospectively as a change of accounting estimate. Intellectual property-related costs for patents are part of the expenditure for the research and development projects.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each financial year.

Internal research costs are those costs incurred for the purpose of gaining new scientific or technical knowledge and understanding. Such costs are always expensed as incurred. Internal development costs are those costs incurred for the application of research findings or other knowledge to plan and develop new products for commercial production. As the drug product development projects undertaken by Faron are subject to technical feasibility, regulatory approval and other uncertainties, these criteria are considered to be met only after Faron has filed its submission to the regulatory authority for final approval after which all subsequent development costs will be capitalised. Before this trigger point all drug product related development costs are typically expensed as incurred. Faron has not capitalised any drug product related development expenditure as the related criteria have not been met yet. Development costs expensed in prior financial years are not capitalised at a later date.

Note 4 Government grants

Faron has received government grants from the EU (Commission's FP7 programme). Grants from governments or similar organisations to support certain projects are accounted for as grants related to income. They are initially recognised at their fair value. Those grants are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate, when management has reasonable assurance that the grant will be received and Faron will comply with the conditions attached to that grant. Such grants are presented as other operating income.

If, at the balance sheet date, grant conditions are believed to be fulfilled and the related grant payments are outstanding, grant receivables are shown in the balance sheet.

Note 5 Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument, e.g. a trade receivable, will fluctuate because of changes in foreign exchange rates.

Faron's functional currency is the euro and Faron is exposed to foreign exchange risk arising from currency exposure, currently mainly with respect to the Japanese Yen and pound sterling. The Company receives foreign currency payments from one of its licence partners Maruishi (based in Japan) in Japanese Yen. However, the impact of the foreign exchange risk arising from the Yen exposure is not considered significant in average.

Due to the commencement of the Phase III clinical trials with a UK based Clinical Research Organisation as main service provider, the Company's' pound denominated expenses and trade payables have become significant. The Company converts most of the pound denominated equity funding proceeds into euros immediately after such funding, but holds a sizeable amount of pounds on its pound sterling bank accounts. This forms a natural hedge against Euro-pound sterling exchange rate changes, as the funds held in pounds roughly match with the estimated pound expenses during 2017. As a result of the sizeable pound sterling holdings, the depreciation of pound sterling against Euro had a negative effect on the financial statements. As the exchange rate may move also to other direction during 2017, the management believes that natural hedge strategy best protects the Company from adverse exchange rate changes and this protection overweighs short term currency rate losses.

Note 6 Other operating income

	2016 € '000	2015 € '000
Grants from EU	1 502	701
Grant component of government loans	237	-
Other items	4	-
Total other operating income	**1 742**	**701**

In 2012 the European Commission awarded a €5,963 thousand grant to the Faron network ("Consortium") to support the FP-1201-lyo clinical phase III programme ("Traumakine"). The Consortium consists of the European Commission as a granting agency, Faron as a coordinator and three other participating partners of the Traumakine programme; University College London Hospital (UCLH), University Sapienza Roma and University of Turku. The first pre-payment for the Consortium under the grant was received in 2013, amounted to €2,299 thousand, and Faron recognised €660 thousand as other operating income. The second Consortium pre-payment, €1,018 thousand was received at the end of 2014 and Faron recognised €111 thousand as other operating income. In 2015, Faron recognised €701 thousand as other operating income.The third pre-payment, €1,781 thousand was received in 2016, and Faron recognised €1,502 thousand as other operating income. In conjunction to each pre-payment Faron has forwarded each Consortium member their respective shares of pre-payments.

Faron draw down first instalments of its third Tekes loan during 2016. As this occured after the date to transition to IFRS (i.e. after 1 January 2014) and therefore it is treated according to IAS 20 and IAS 39. The benefit of a government loan with a below market rate interest is treated as a government grant and accounted for in accordance with IAS 20. The loan component is recognised and measured in accordance with IAS 39 initially at fair value and subsequently at amortised cost over the loan period by using the effective interest method. The benefit of the below market rate is measured as the difference between the initial carrying value of the loan, i.e. the fair value, and the proceeds received from the government. Government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Thus the grant component of €237 thousand is recorded in 2016 in Other operating income.

The Other items are €4 thousand legal costs returned to the Company.

Note 7 Financial income and expenses

Faron has received three goverment loans for research and development purposes with below-market interest rate from Tekes (The Finnish Funding Agency for Technology and Innovation). Two of theses loans were drawn down before the date to transition to IFRS (i.e. prior to 1 January 2014). Thus, based on the exemption under IFRS 1, Faron has measured the government loans using the previous FAS carrying amount as the carrying amount of the loan. Subsequently, both loans are carried at amortised cost using the effective interest rate. The total loan periods are 10 years from the draw-down. The interest rate for these loans is the base rate set by the Finnish Ministry of Finance less 1%, however, the interest rate will not fall below a 1% minimum. Repayment of these loans shall be initiated after 5 years, thereafter loan principals shall be paid back in equal installments over the remaining loan period. In certain circumstances Tekes may, at its own discretion, extend the loan terms, convert the loans into capital loans or exempt the Company from repayment following the general terms of the loans. The loans do not include any covenants. The Company has negotiated with Tekes four years extension to the first loan and an equal postponement of the installments and a years extension to the first loan and an equal postponement of the installments. Therefore the first instalment of the first loan is due in April 2018 and for the second loan in February 2019.

Other significant financial expense items are the exchange rate losses when transfering GBP to Euro, when issuing the new shares entering London stock exchange, expenses on loan guarantees, interest on convertible loans and credit limit interest from bank.

Financial income	2016 (€,000)	2015 (€ ,000)
Interest from bank balances	0	0
Interest from account receivables	0	0
Total financial income	0	0

Financial expenses		
Interest on government loans (Tekes)	(19)	(18)
Interest on bank loans	(5)	(19)
Interest on accounts payables	(1)	(1)
Exchange rate losses	(333)	(247)
Bank guarentee costs and provisions	(2)	(9)
Other financial expenses	(1)	(17)
Total financial expenses	(361)	(311)
Total financial income and expenses	**(361)**	**(311)**

Note 8 Income taxes

Withholding tax	(75)	(42)
Total income taxes	(75)	(42)

Taxes paid in the year ended 31 December 2015 and 2016 relate to milestone payment from Maruishi and signing fee from PharmBio.

Reconciliation of effective tax rate

The Finnish corporate tax rate applied was 20%.

Loss before income tax	(9 294)	(6 188)
Tax using Faron's domestic corporate tax rate	1 859	1 238

Current-year losses for which no deferred tax asset is recognised	(1 859)	(1 238)
Taxes in the income statement	-	-

Items for which Faron has not recognised a deferred tax asset

R&D expenses not yet deducted in taxation[1]	2 816	2 816
The tax losses carried forward approved by tax authorities[2]	13 928	5 434
Deductible temporary differences for which no deferred asset have been recognised	16 744	8 250

1) Faron has incurred research and development costs in the financial years ended 31 December 2010 and 2011 that have not yet been deducted in its taxation. The amount can be deducted over an indefinite period with amounts that the Company may freely decide.

2) These losses expire over the years 2019 to 2025. The amount presented for the year ended 31 December 2016 does not include the deductible temporary difference arisen from the net loss for the financial year 2016 as the related loss has not yet been approved by tax authorities by the time of preparation of these financial statements.

The related deferred tax assets have not been recognised in the balance sheet due to the uncertainty as to whether they can be utilised.

Note 9 Loss per share

Basic

Basic loss per share is calculated by dividing the loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

Loss attributable to equity holders of the Company (€ ,000)	(9 294)	(6 188)
Weighted average number of ordinary shares in issue	23 979 650	20 686 854
Basic (and dilutive) loss per share, €	(0,39)	(0,30)

Weighted-average number of ordinary shares		
Issued ordinary shares at 1 January	23 111 704	15 456 250
Effect of shares issued	867 945	5 230 604
Weighted-average number of ordinary shares at 31 December	23 979 650	20 686 854

Diluted

Diluted loss per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

Loss attributable to equity holders of the Company (€ ,000)	(9 294)		(6 188)
Interest adjustment	-	9	9
Convertible loan interest adjusted loss attrib to equity holders (€ ,000)	(9 294)		(6 179)
Diluted weighted average number of ordinary shares in issue	23 979 650		20 686 854
Basic loss per share, €	(0,39)		(0,30)

Weighted-average number of ordinary shares		
Issued ordinary shares at 1 January	23 111 704	15 456 250
Effect of shares issued	867 945	5 230 604
Weighted-average number of ordinary shares at 31 December	23 979 650	20 686 854
Dilution effect of convertible loans'	-	-
Diluted weighted-average number of ord. shares at 31 December	23 979 650	20 686 854

	€ '000	€ '000

Note 10 Equity and reserves

	Number of shares (pcs)	Share capital (1,000 €)	Reserve for invested non-restricted equity (1,000 €)	Total (1,000 €)
In issue at 1 January 2013	1 453 380	1 296	5 328	6 624
Conversion of convertible notes to shares	3 688	120	0	120
Issued for merger consideration	1 000 000	0	0	0
Cancelled in merger	-1 000 000	0	0	0
31 December 2013	**1 457 068**	**1 416**	**5 328**	**6 744**
Share issues, issued for cash	35 424	1 275	0	1 275
Issue of convertible equity instrument	0	0	1 126	1 126
Warrants issue	53 133	0	0	0
31 December 2014	**1 545 625**	**2 691**	**6 453**	**9 144**
Share base payments	0	0		0
Convertible issue	78 166			0
Share issues for cash	302 764		5 050	5 050
Total	**1 926 555**			0
Split 1:10	19 265 550			0
Emission of new shares	3 846 154		13 030	13 030
31 December 2015	**23 111 704**	**2 691**	**24 533**	**27 224**
Share base payments	0	0		0
Emission of new shares	3 200 000		8 519	8 519
31 December 2015	**26 311 704**	**2 691**	**33 052**	**35 743**

Faron Pharmaceuticals Ltd. has one class of shares. The shares amounted to 23,111,704 at 1 January 2016. The following increases were made during 2016:

a) by a resolution of a Board Meeting held on 21 September 2016 made pursuant to an authority granted to the Board of Directors at the Annual General Meeting held on 26 May 2016, the Company resolved to issue a total of 3,200,000 Ordinary Shares.

The company was listed on the London Stock Exchange in November 2015. The share has no nominal value. Each share entitles the holder to one vote at the Annual General Meeting. All shares entitle holders to an equal dividend.

At the 31 December 2016 Faron's share capital, entered in the Finnish trade register, amounted to € 2,691 thousand. The number of Ordinary Shares at 31 December 2016 was 26,311,704.

Details on the management shareholding are disclosed in Note 13. Transactions with Related Parties.

Nature and purpose of reserves

Share capital

The subscription price of a share received by the company in connection with share issues is recorded to the share capital, unless it is provided in the share issue decision that a part of the subscription price is to be recorded in the fund for invested non-restricted equity. The proceeds received by Faron from the conversion of the convertible bonds have been credited to share capital.

Fund for invested non-restricted equity

The fund for invested non-restricted equity includes other equity investments, for which part of the subscription price of the shares according to the related decision is not to be credited to the share capital and issuance of convertible capital loans.

Faron has not paid any dividends over the years.

Note 11 Current receivables

(€,000)

	2016	2015
Trade receivables	579	37
Prepayments	1 250	1 248
Accrued items	134	17
Other receivables	1 441	772
Total trade and other receivables	**3 404**	**2 074**

The majority of prepayments relate to the Clinical Service Agreement with the clinical research organisation (CRO), which is the main service provider for the INTEREST -study. The other receivables consist mainly of the EU FP7 grant income as described in Note 4.

Note 12 Financial liabilities and other liabilities

(€ ,000)

Non-current financial liabilities and other liabilities

Interest-bearing financial liabilities		
Tekes loan	2 033	1 446
Convertible notes	-	-
Total non-current financial liabilities	2 033	1 446
Other non-current liability		
Total other non-current liabilities		
Total non-current liabilities	**2 033**	**1 446**

Current financial liabilities and other liabilities

Interest-bearing financial liabilities		
Convertible notes	-	-
Goverment loans (current portion)	93	245
Bank overdraft facility	-	-
	93	245
Non-interest-bearing financial liabilities		
Trade payables	1 874	436
	1 874	436
Other liabilities		

Prepayments	1 718	973
Accrued expenses	620	515
Other liabilities	65	29
	2 403	1 517
Total current financial liabilities and other liabilities	**4 371**	**2 197**

The item "Prepayments" above comprises portions of the awarded EU grant, received in 2013 and 2014. For further information, see Note 6. Other operating income.

For the years 2015 and 2016 the major item under "Accrued expenses" are personnel related (short-term employee benefits).

	2016	**2015**

Note 13 Transactions with related parties

Related parties of the Company

Faron's related party comprise of the following:

Ÿ A&B (HK) Company Limited, an investment company existing under the laws of Hong Kong having significant influence in Faron Pharmaceuticals Oy, given their shareholding of 12.9%, as at 31 December 2016.

Ÿ Marko Salmi, a private person having significant influence over Faron Pharmaceuticals Oy, given his shareholding of 12.9%, as at 31 December 2016.

Ÿ Board of Directors; and

Ÿ the Company's key management personnel (see below)

Faron had no interests in other entities at the end of the reporting periods presented in these financial statements.

Transactions with related parties

Faron has not carried out any transactions with related parties in the financial years presented in these financial statements, except that the former parent company of Faron Pharmaceuticals Ltd., Faron Holding Ltd., merged into its subsidiary Faron Pharmaceuticals Ltd. on 31 December 2013.

Key management personnel

The Company's key management personnel consist of the following:

- members of the Board of Directors
- Management Team comprising: CEO Markku Jalkanen, PhD; VP Ilse Piippo, MD, MSc (Pharm), Operations director. Mikael Maksimow, PhD, Medical director Matti Karvonen, MD, PhD and CFO Yrjö Wichmann, MSc (Econ)

Remuneration of key management personnel*

Salaries and other short-term employee benefits	832	769
Share based payment	274	33
Post-employment benefits (defined contribution plans)		-
Total	**1 106**	**802**

Remuneration to the Board of Directors **

Salaries and other short-term benefits	258	124
Share based payment	38	155
Total	**296**	**279**

**Presented information for the Management Includes the executive directors of the Board*

***Presented information for the Board includes only non-executive directors.*

Management and Board shareholding

Management shareholding, 31 December 2016*

Number of shares (pcs)	2,965,170
Shareholding, percentage	11.3 %

*Board** shareholding, 31 December 2016*
(excluding the shareholding of CEO and CFO)

Number of shares (pcs)	1,607,489
Shareholding, percentage	6.1 %

Total number of shares outstanding at 31 December 2016 (pcs)	26,311,704

**Presented information for the Management Includes the executive directors of the Board*
***Presented information for the Board includes only non-executive directors.*

END

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