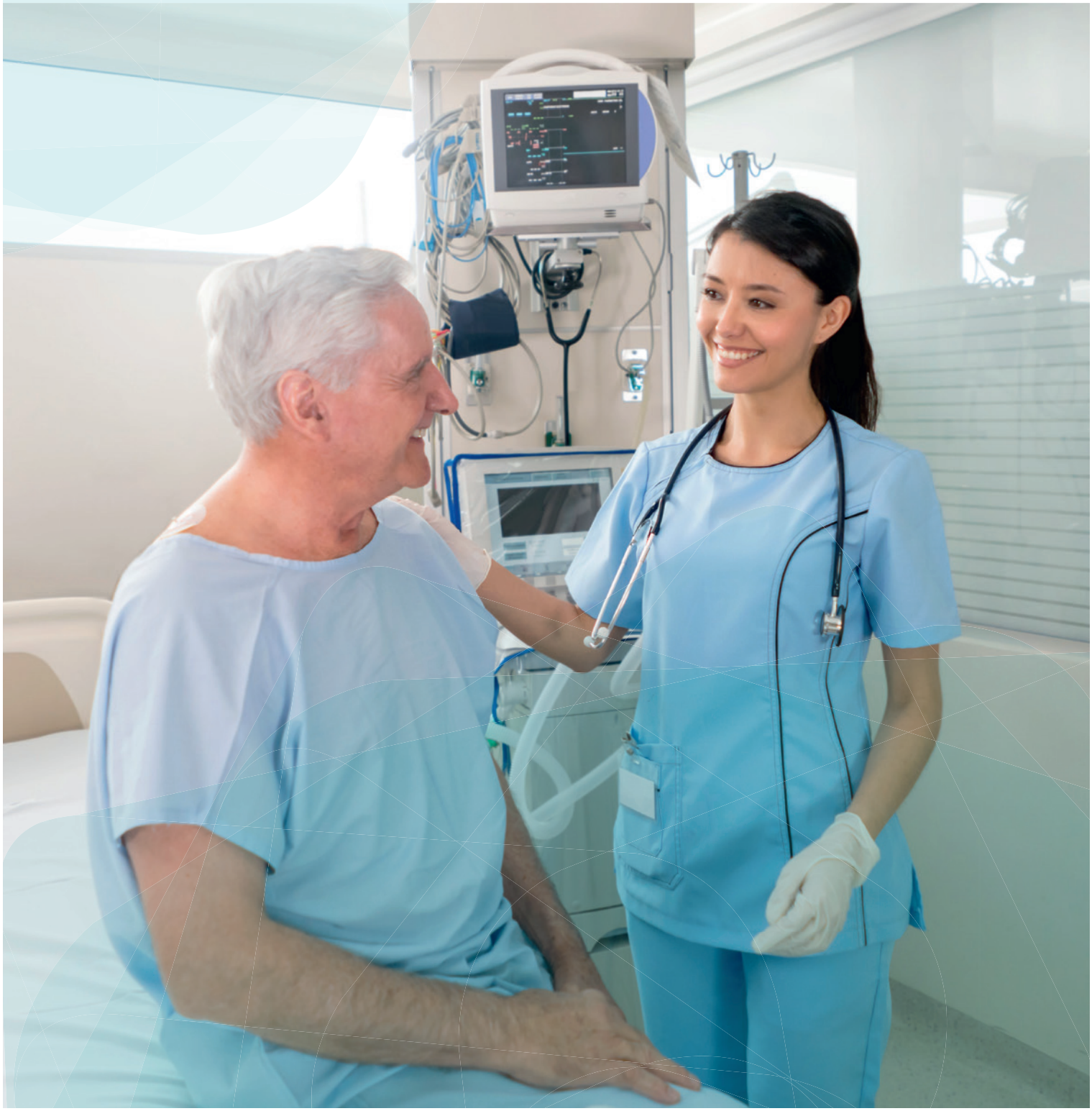
POLYPHOR

Annual Report 2017



Annual Report 2017

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Polyphor at a glance

We are a clinical stage biopharmaceutical company based in Allschwil, Switzerland, which has discovered and is developing the OMPTA (Outer Membrane Protein Targeting Antibiotics). The OMPTA are potentially the first new class of antibiotics against Gram-negative bacteria to have reached Phase III stage in the last 50 years. The company's lead product, the precision antibiotic murepavadin (POL7080), is in Phase III development against *Pseudomonas aeruginosa* – recognized as a critical priority 1 pathogen by the World Health Organization "WHO". We are also developing balixafortide (POL6326), an immuno-oncology compound for combination treatment in metastatic breast cancer tested in a Phase Ib clinical trial and have out-licensed the development and commercialization of the inhaled neutrophil elastase inhibitor POL6014 (Phase Ib) to Santhera Pharmaceuticals. In addition, we have a pipeline of further preclinical antibiotics based on our OMPTA platform.

Highlights and Key figures in 2017

- Positive meeting with FDA and EMA to advance murepavadin into Phase III
- Raised CHF 40 million to finance the beginning of the Phase III murepavadin trial
- Development of the inhaled version of murepavadin to expand its use to the chronic treatment in patients with cystic fibrosis and non-cystic fibrosis bronchiectasis
- Promising preclinical results of OMPTA compounds on resistant Gram-negative strains
- Exciting results for balixafortide's proof of concept in advanced breast cancer
- Restructuring of the Collaboration Services business unit
- In February 2018, out-licensing of POL6014 to Santhera Pharmaceuticals AG for a CHF 6.5 million upfront payment in Santhera shares and CHF 121 million in potential future milestone payments and tiered up to double digit royalties based on sales.

CHF millions
(Based on 2017 audited statutory financial statements)

Profit and Loss	**2017**	**2016**	**Variance in %**
Total income	4.4	8.7	-49.1
Research and development expenses and cost of materials	-14.2	-11.7	21.2
Employee expenses	-16.1	-14.1	14.4
Other operating expenses	-7.0	-5.3	33.4
Net loss	-40.3	-21.2	90.4
Balance Sheet, CHF Mio.			
Cash and cash equivalents	24.6	14.6	68.3
Total assets	40.3	36.5	10.5
Total shareholders' equity	24.6	25.6	-3.7
Average net cash burn *	2.5	1.9	33.7
Number of FTE	92	89	3.4
Equity ratio	61%	70%	–

* The average net cash burn represents the average monthly cash used for operating and investing activities

Chairman and Chief Executive Officer's Letter

Argeris ("Jerry") M. Karabelas, Ph.D.

Giacomo Di Nepi

Dear shareholders,

After our transition year in 2016, when we extended the runway, turned around murepavadin and focused on the development of the portfolio, we turned our focus this year to our strategy and mission. Our main goal is to become a sustainable biopharmaceutical company focused on innovative antibiotics meeting unmet medical needs and other specialty products, bringing first-in-class or best-in-class new medicines to patients.

Key milestones

In 2017, Polyphor continued to make substantial progress with its product pipeline. A significant highlight was the successful end of Phase II meeting with the US Food and Drug Administration (FDA) and a positive scientific advice from the European Medicines Agency (EMA), clearing the path for a rapid advancement of murepavadin forward into Phase III. For our FDA trial we reached agreement with the FDA on a record non-inferiority margin, which means that we will need only 210 patients with a pulmonary *Pseudomonas aeruginosa* infection for the FDA trial. This has obvious positive implications on costs and duration of the pivotal trial. In addition, we were also encouraged by the EMA to make an even smaller trial (120 patients), complemented by a strong microbiology, to accelerate the availability of the drug. We have also made progress in the identification of the overall market potential for this drug. We believe murepavadin could potentially become the standard of care in the treatment of patients affected by multi-drug resistant *Pseudomonas aeruginosa* (PA) nosocomial pneumonia infections and also get additional use in other patient segments.

A further milestone was the initiation of the development of an inhaled formulation of murepavadin, creating the potential to expand its use to the chronic treatment of people with cystic fibrosis and non-cystic fibrosis bronchiectasis. Expanding the indication would also mean significantly expanding the market potential. This development program leverages the iABC (inhaled Antibiotics in Bronchiectasis and Cystic Fibrosis) project dedicated to the development of inhaled antibiotics – a consortium including leading lung specialists in 18 hospitals and research institutions in eight European countries. These institutions will receive up to EUR 5 million for their support of the development of the inhaled formulation of murepavadin up to proof of concept in man from the Innovative Medicines Initiative (IMI) representing up to 50% of the anticipated costs up to proof of concept in man.

We also made significant progress in the discovery and early development of novel medium-spectrum, outer membrane protein targeting antibiotics ("OMPTA"). Preclinical studies indicate a powerful activity on resistant Gram-negative strains. This has triggered, ahead of schedule, a milestone payment from the Wellcome Trust, a global charitable foundation supporting this program.

Another exciting milestone this year was the proof of concept data of balixafortide (POL6326) in metastatic breast cancer. Balixafortide showed strong results in a Phase Ib / proof of concept clinical trial in combination with eribulin in patients affected by advanced metastatic breast cancer and has the potential to benefit from expedited regulatory programs in the United States and Europe. In addition, we believe balixafortide provides further upside potential in connection with other indications and further combinations with other agents.

Adding to the positive pipeline development, the inhaled neutrophil elastase inhibitor POL6014 showed strong proof of mechanism data in the sputum of people with cystic fibrosis. The compound, as part of the overall focus strategy, has been successfully out-licensed to Santhera in February 2018 for an upfront payment of CHF 6.5 million in Santhera shares, potential milestone payments of up to CHF 121 million and tiered up to double-digit royalties based on sales.

Finally, in December 2017, we restructured our Collaboration Services business – while retaining the part we need for the antibiotics research. This was a difficult but necessary decision as the business, despite its achievements and commercial status since many years, was and is not financially self-sustainable and detracted from the overall focus of the company.

The achievements of this year have been made possible thanks to the financial support of CHF 40 million raised in 2017 mostly from existing shareholders. We highly appreciate the support and would like to give you our heartfelt thanks for the confidence and trust you put in our company, team and strategy. We would also like to thank our employees for their dedication, hard work, commitment and their valuable contribution which drives the success of this company. We are also very happy that Debra Barker and Kalina Scott joined Polyphor in 2017 to strengthen our management team as Chief Medical & Development Officer and Chief Financial Officer, respectively. Their experience, skills and expertise will be instrumental to further develop the company in this important phase.

While 2017 has been the year of focus, we will be working on building up our pharma business in 2018 by further developing our clinical stage programs focused on the antibiotic franchise and possibly balixafortide in oncology. The first half of 2018 will be full of important events to be delivered. The initiation of the Phase III trial of our lead compound murepavadin with the first patient expected to be dosed will be a significant milestone for the company. Further, applying for a grant from the Biomedical Advanced Research and Development Authority (BARDA), early this year, will be a challenging but, if successful, highly rewarding opportunity. To further advance our antibiotics franchise, we plan to select one preclinical candidate from our OMPTA platform in the first half of 2018 and advance it to the clinic by end of 2019. This will expand and diversify our antibiotic pipeline.

We will have an end of Phase I meeting with the FDA in the first quarter and the Phase II design for our oncology compound balixafortide in advanced breast cancer combination therapy; in addition, the dialogue with the Agency will help us to assess the potential to file for a fast track and / or breakthrough status in this indication. At the same time, we are also exploring the possibilities for combining this compound with other oncology therapies, such as the check-point inhibitors, and to pursue a partnering of this compound.

The out-licensing of POL6014 in February 2018 was a strategic decision to increase the focus, contain the financial needs and provide a return on our investment. We selected Santhera Pharmaceuticals as our partner among a number of interested and capable parties because of its focus and commitment towards orphan drugs, with a strong and experienced team, in the field of rare diseases and in the respiratory field. Under the terms of the agreement, Polyphor will receive an upfront payment of CHF 6.5 million paid in the form of Santhera shares and could receive up to an additional CHF 121 million in potential development, regulatory and sales milestones for the initial indication, as well as tiered royalties, up to double-digit, on sales. Santhera will have the exclusive worldwide development and commercialization rights. Additional payments are foreseen if the compound is developed in additional indications.

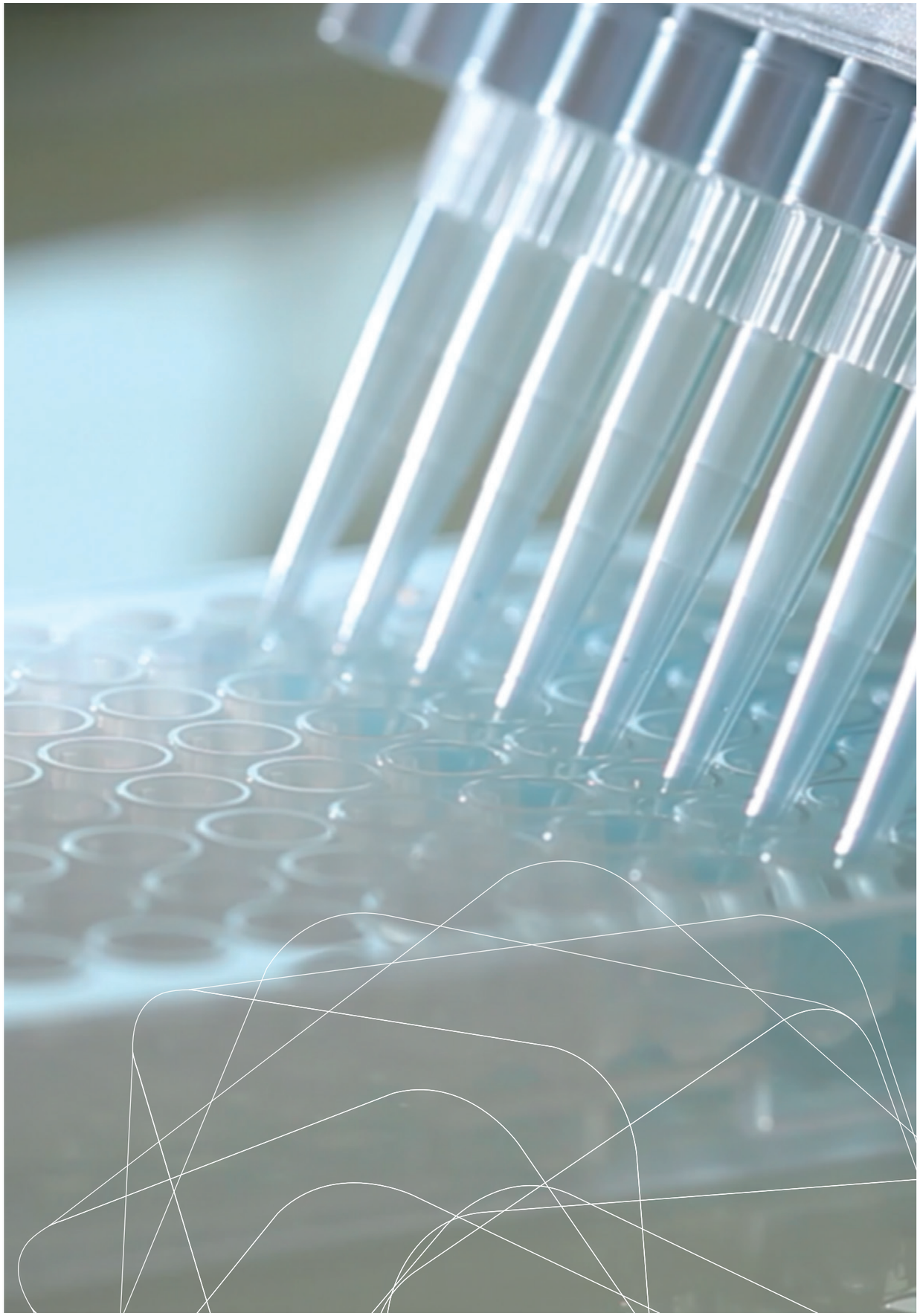
We will also explore a variety of financing options to support the Phase III trial of murepavadin. The selection of the best opportunity will depend on market and other conditions.

We believe that the implementation of our focused strategy has the potential to deliver substantial value creation opportunities to shareholders. We will do everything to exceed the expectations and we are confident that, with the support of our shareholders, employees and partners, we will be successful.

Sincerely

Jerry Karabelas
Chairman of the Board

Giacomo Di Nepi
Chief Executive Officer



Portfolio and Pipeline

We are a clinical stage biopharmaceutical company based in Allschwil, Switzerland, and are focused on the discovery and development of antibiotics and other specialty products for severe or life-threatening diseases. Our lead antibiotics product candidate murepavadin (POL7080), which is being developed for the treatment of nosocomial pneumonia due to *Pseudomonas aeruginosa*, recently entered Phase III clinical development. In addition, we have two other product candidates that are also currently in clinical development: balixafortide, an immuno-oncology compound, and POL6014, a respiratory drug which we recently out-licensed. We focus principally on the area of antibiotics addressing antimicrobial resistance and the development of new antibiotics with a novel mechanism of action, especially against Gram-negative pathogens. We aim to become a sustainable biopharmaceutical company focused on innovative antibiotics meeting unmet medical needs and other specialty products, bringing first-in-class or best-in-class new medicines to patients.

We established our current operations focused on the research of macrocycles more than a decade ago. Macrocycles are medium size cyclic molecules that complement the chemical space between small molecules and large biologics and are designed to address complex and challenging extra- and intracellular biological targets, while keeping the advantages of small molecules. In collaboration with the University of Zurich, we have established a proprietary macrocycle-based discovery platform, based on two complementary technologies: PEMfinder® and MacroFinder®.

We have discovered a new class of antibiotics, outer membrane protein targeting antibiotics ("OMPTA"), using our "Protein Epitope Mimetics" ("PEM") platform. OMPTAs are characterized by a low rate of resistance development and offer new treatment options for patients with difficult-to-treat infections caused by Gram-negative pathogens (including multidrug resistant ("MDR") and extensively drug-resistant ("XDR") strains). Murepavadin is our first antibiotic of the OMPTA class to reach Phase III clinical development, making OMPTAs potentially the first new class of antibiotics in Phase III clinical development against Gram-negative pathogens in 50 years.

Besides developing murepavadin and other new OMPTA antibiotics, we have an innovative pipeline of PEM product candidates derived from our proprietary macrocycle platform providing further upside potential in the fields of oncology and respiratory diseases.

Portfolio and Pipeline

Deep pipeline of promising drug candidates derived from macrocycle discovery platform

		Partner / collaborator	Preclinical	Phase I	Phase II	Phase III	Strategy to 2022
Antibiotics • Murepavadin	OMPTA[1]	Co-funded by IMI	*Pseudomonas aeruginosa* infections				Commercialize
• Murepavadin (aerosol formulation)			CF / NCFB[2]				Develop to proof of concept
• New medium spectrum antibiotic		Co-funded by the Wellcome Trust	Discovery				Develop to proof of concept
Oncology • Balixafortide + eribulin	CXCR4 antagonist		Metastatic breast cancer				Co-develop / out-license
• Balixafortide + other			Other solid tumors				Co-develop / out-license
Respiratory • POL6014	Inhaled elastase inhibitor	santhera[3,4]	Cystic Fibrosis				Out–licensed to Santhera

Current status

Strategy to 2022

Note:

[1] Outer Membrane Protein Targeting Antibiotics

[2] Cystic Fibrosis / Non-Cystic Fibrosis Bronchiectasis

[3] Outlicensing deal closed on 14.02.2018

[4] Project supported by the US Cystic Fibrosis Foundation

Portfolio and Pipeline

In the field of antibiotics, our product candidates and programs comprise:

Murepavadin

Murepavadin (POL7080) is our most advanced product candidate and the first OMPTA in clinical development. In contrast to commonly used broad-spectrum antibiotics, murepavadin is a pathogen-specific antibiotic and is being developed for the treatment of nosocomial pneumonia (including both hospital-acquired ("HABP") and ventilator-associated bacterial pneumonia ("VABP")) due to *Pseudomonas aeruginosa*. It was granted Qualified Infectious Disease Product ("QIDP") and fast track designation from the FDA for the treatment of ventilator-associated bacterial pneumonia due to *Pseudomonas aeruginosa*. Based on promising Phase II results, we agreed on a streamlined development pathway for murepavadin with the FDA and the EMA and recently started our first Phase III clinical trial.

Murepavadin inhaled

We are developing an inhaled formulation of murepavadin for the treatment of chronic *Pseudomonas aeruginosa* infections in patients with cystic fibrosis, non-cystic fibrosis bronchiectasis and as an additional treatment for nosocomial pneumonia due to *Pseudomonas aeruginosa*. This development program leverages the iABC (inhaled Antibiotics in Bronchiectasis and Cystic Fibrosis) project dedicated to the development of inhaled antibiotics – a consortium including leading lung specialists in 18 hospitals and research institutions in eight European countries. These institutions will receive up to EUR 5 million for their support of the development of the inhaled formulation of murepavadin up to proof of concept in man from the Innovative Medicines Initiative (IMI) representing up to 50% of the anticipated costs up to proof of concept in man.

New OMPTAs

Beyond the development of murepavadin, we are conducting research for the development of additional OMPTAs targeting the most resistant Gram-negative pathogens. We are concentrating our efforts on the further optimization of the potency and properties of the PEM molecules required for a development candidate and aim to select a medium spectrum preclinical candidate targeting the most resistant MDR strains of all Gram-negative ESKAPE pathogens to meet unmet medical needs in the first half of 2018 and to start Phase I studies by the end of 2019.

Portfolio and Pipeline

In addition to the further development of our antibiotics, we have the following product candidates:

Balixafortide

Balixafortide (POL6326) is a potent and selective antagonist of the chemokine receptor CXCR4 that is being developed to improve therapy outcomes in cancer, when used in combination with other agents. Balixafortide is an immuno-oncology compound increasing immune cells infiltration into the tumor and rendering cancer cells more susceptible to chemo and immunotherapies. Clinical proof of concept has been achieved in a Phase Ib study in combination with eribulin in patients with advanced metastatic breast cancer.

POL6014

POL6014 is a potent, selective and reversible inhibitor of the aggressive lung degrading enzyme neutrophil elastase which we developed for the treatment of chronic inflammation in cystic fibrosis patients and which we believe has further potential in other respiratory indications. We discovered and advanced POL6014 into clinical development up to the demonstration of proof of mechanism in a Phase Ib clinical trial in cystic fibrosis patients. In February 2018, we exclusively out-licensed POL6014 to Santhera on a worldwide basis for the treatment of any disease.

Our Strategy

Our main objective is to become a sustainable biopharmaceutical company focused on innovative antibiotics which are meeting unmet medical needs and other specialty product candidates, bringing innovative first-in-class or best-in-class medicines to patients. Our strategy to achieve this goal is:

Continue to advance the development of our most advanced product candidate, murepavadin, in nosocomial pneumonia towards regulatory approval

Murepavadin successfully completed Phase II clinical trials and recently entered Phase III clinical development. We have established with both the FDA and EMA a streamlined development pathway towards completion of Phase III clinical development for murepavadin, comprising two clinical trials with a planned recruitment of an aggregate of 330 patients with confirmed nosocomial pneumonia due to *Pseudomonas aeruginosa* and aim to accelerate its availability to patients in need. We believe that its launch could provide a paradigm shift in the treatment of patients with nosocomial pneumonia from *Pseudomonas aeruginosa* and substantially improve the treatment of patients affected by its most aggressive MDR and XDR strains and gain additional ground in the treatment of patients with usual drug resistance ("UDR") strains in centers with strong antibiotic stewardship enforcement as well as in the empiric treatment of patients at high risk of *Pseudomonas aeruginosa* infection. While murepavadin could eventually be partnered, we believe its marketing will require only a small hospital field force and a targeted marketing investment, therefore allowing us to easily and successfully commercialize it and bring it to the patients.

Advance the development of inhaled murepavadin

In addition, we aim to further develop an inhaled formulation of murepavadin. About two thirds of adult patients with cystic fibrosis and around one third of patients with non-cystic fibrosis bronchiectasis develop a colonization of *Pseudomonas aeruginosa* requiring chronic management – currently treated with broad spectrum inhaled antibiotics. An inhaled formulation of murepavadin may provide an important, targeted and potentially superior treatment option for these patients, bring it to an orphan status in cystic fibrosis, and expand its use from hospital to home-based and from acute to chronic use.

Our Strategy

Leverage the OMPTA class

We intend to further leverage the OMPTA class and will continue to exploit the advantages of this new class of antibiotics to discover and develop novel product candidates. We are currently in the process of selecting a new medium spectrum preclinical candidate to target the most resistant MDR strains of all Gram-negative ESKAPE pathogens and are aiming to start clinical development for this product candidate by the end of 2019.

Selectively develop balixafortide

Balixafortide has shown promising results in the proof of concept study in combination with the cancer agent eribulin in advanced metastatic breast cancer and we believe that it can benefit from specific regulatory pathways in this combination and indication which could accelerate its development. In addition, we believe its mechanism of action could further expand its use to a number of other indications / other combinations (e.g. with checkpoint inhibitors). If we are eligible for the accelerated approval pathway in the United States, we will seek to enter into a collaboration with a partner for the co-development and co-commercialization of balixafortide for breast cancer, in order to capture part of the value creation, while allowing the full exploitation of the potential in other indications and combinations. If we are not eligible for the accelerated approval pathway or, despite such eligibility, are not able to establish a collaboration for the co-development or co-commercialization, we intend to completely out-license balixafortide.

Out-license POL6014

In line with our overall strategy, we have out-licensed POL6014 to Santhera in February 2018.

Our Strengths

We believe our core strengths include the following:

We have discovered and developed a new class of antibiotics for Gram-negative pathogens

The most aggressive pathogens are Gram-negative pathogens, representing four of the six ESKAPE (*Enterococcus faecium, Staphylococcus aureus, Klebsiella pneumoniae, Acinetobacter baumannii, Pseudomonas aeruginosa and Eenterobacter spp*) pathogens which are the leading cause of severe infections throughout the world. Many of their strains are becoming resistant to most – and in some cases all – commonly used antibiotics. Despite this development only a few new antibiotics have been introduced over the last decade. All of these were modifications of existing antibiotic classes and they address specific resistance mechanisms. In order to overcome the worldwide emergence of resistance to existing antibiotic classes, we believe agents with a new mechanism of action are required. OMPTAs are potentially the first new class of antibiotics against Gram-negative pathogens that have reached Phase III clinical development in more than 50 years. We believe their novel mechanism of action, overcoming the outer membrane of Gram-negative pathogens, provides for the potential to develop highly effective antibiotics against which pathogens may only slowly build resistance. Therefore, we believe OMPTAs represent a true innovation. Other new mechanisms of action against Gram-negative pathogens are neither included in recently introduced antibiotics nor in other Phase III product candidates.

Our lead product candidate murepavadin has the potential to lead to a paradigm shift in the fight against *Pseudomonas aeruginosa*

Among the Gram-negative pathogens, *Pseudomonas aeruginosa* is one of the most dangerous. It is responsible for approximately 10% of all hospital-acquired infections and the second leading cause of nosocomial pneumonia with mortality rates of 30–40%. In 2017, its strain that is resistant against the widely used antibiotic class of the carbapenems has been classified as one of the top three critical pathogens by the World Health Organization. Murepavadin has shown promising Phase II results in a clinical trial in patients with VABP corroborated by a strong microbiology – including the most resistant strains. In contrast to commonly used broad-spectrum antibiotics, murepavadin is a precision medicine and as such it supports the growing practice known as “antibiotic stewardship” which, among other things, seeks to reduce the excessive use of broad-spectrum products to avoid the buildup of resistance and to preserve the microbiome of the patients. We estimate that murepavadin could be addressing a significant market opportunity. We believe murepavadin may lead to a paradigm shift in the treatment of nosocomial pneumonia due to *Pseudomonas aeruginosa* and become

Our Strengths

the standard of care in the treatment of patients with confirmed nosocomial pneumonia due to MDR and XDR strains of *Pseudomonas aeruginosa* and expect additional potential to come from the use in centers practicing strong antibiotic stewardship as well as in the empiric treatment of patients at high risk of *Pseudomonas aeruginosa* infection.

We have further upside potential from our innovative pipeline of assets

In addition to developing murepavadin, we have an innovative pipeline providing further upside potential. In line with our focus on antibiotics we aim to select a new medium spectrum OMPTA preclinical candidate targeting the most resistant MDR strains of all Gram-negative ESKAPE pathogens in the first half of 2018. Our immuno-oncology compound balixafortide showed strong results in a Phase Ib / proof of concept clinical trial in combination with eribulin in patients affected with advanced metastatic breast cancer and has the potential to benefit from expedited regulatory programs in the United States and Europe. In addition, we believe balixafortide provides further upside potential in connection with other indications and further combinations with other agents. POL6014, our potent, selective and reversible neutrophil elastase inhibitor, has successfully completed two Phase Ib clinical trials for the treatment of chronic inflammation in cystic fibrosis patients and we believe that it has further potential in other respiratory indications. While we believe that our partner Santhera can advance POL6014 through further clinical development in this indication and, potentially, through preclinical and clinical development for other indications, Santhera has not yet announced any specific development plans.

Our team is comprised of highly experienced drug development professionals with successful track records

We have an internationally-trained team of more than 65 employees. These include specialists with in-depth experience and capabilities in the fields of biology, chemistry, drug discovery, clinical development and commercialization. The team is comprised of highly experienced drug development professionals with successful track records at leading companies including Roche, Novartis and InterMune. In particular, Giacomo Di Nepi, our CEO, who was most recently Executive Vice President and General Manager Europe, for InterMune, where he launched an orphan drug, and built a USD 140 million business with 200 employees. In addition, our Board of Directors has complementary backgrounds in the leadership and successful stewardship of private and public pharmaceutical companies, research and development, finance and Mergers & Acquisitions.

Corporate Governance

I. Principles

Polyphor is committed to complying with all relevant corporate governance requirements, in particular all applicable laws and regulations. The principles and rules of Polyphor's corporate governance are laid down in the articles of association (*Statuten*) (the "Articles") and the organisational regulations (*Organisationsreglement*) (the "Organisational Regulations").
Polyphor believes that a strong Board of Directors, representing both the interests of the shareholders and other stakeholders, as well as highly skilled managers of integrity are critical to its success.

II. Legal Structure

Polyphor is a Swiss stock corporation (*Aktiengesellschaft*) with registered seat in Allschwil. The company has one subsidiary: Polyphor UK Ltd., London, UK.

III. Capital Structure

The year 2017 saw some significant changes to the company's capital structure. In April 2017, the annual general meeting of shareholders (*ordentliche Generalversammlung*, "AGM") decided on a 1:50 share split, increasing the number of shares from 114'242 to 5'712'100 while reducing the nominal value of each share from CHF 100 to CHF 2. At the same time, the ordinary share capital was increased by CHF 412'064 through the issuance of 206'032 new shares. In August 2017, the share capital was further increased by CHF 1'234'770 through the issuance of 617'385 new shares. Finally, in December 2017, the share capital of the company was increased by a further CHF 294'888 through the issuance of 147'444 new shares. As at the end of 2017, Polyphor had a share capital of CHF 13'365'922 made up of 6'682'961 registered ordinary shares at a nominal value of CHF 2 each.

Corporate Governance

IV. Board of Directors and Executive Management

A. The Board of Directors

1. General information

The Articles provide that the Board of Directors (*Verwaltungsrat*) of the company (the "Board") shall consist of up to seven members. As at the end of 2017, the Board had seven members (each a "Director").
Directors are appointed to and removed from the Board exclusively by the general meeting of shareholders. The maximum term of office for a Director is the time period starting at his or her election and ending upon completion of the following AGM. Re-election is permitted. The Board organizes itself and elects from among its members a chairperson (the "Chairman") and a deputy chairperson (the "Vice-Chairman"). The secretary of the Board does not need to be a Board member.
According to the Articles and the Organisational Regulations, the Board meets at the invitation of the Chairman or, if he is unable to do so, of the Vice-Chairman or of another Director, as often as required, or whenever a Director indicating the reasons so requests in writing. Board resolutions are passed by a majority of the votes cast. In the case of a tie, the Chairman has no deciding vote. Subject to certain exceptions, the Board is quorate when a majority of its members are present. Resolutions may be passed by way of circulation in writing, provided that no Director requests oral deliberations or a meeting, respectively.

2. Power and Duties

The Board is responsible for the ultimate direction of the company's business and the supervision of the persons entrusted with the company's management. The Board represents the company vis-à-vis third parties and manages all matters that have not been delegated to another corporate body by law, the Articles, the Organisational Regulations or other regulations.
The Board's non-transferable and inalienable duties include: (i) the ultimate management of the company and the giving of the necessary directives in this regard; (ii) the determination of the organization of the company; (iii) the structuring of the accounting system, financial controls and financial planning; (iv) the appointment and removal of the persons entrusted with the management and representation of the company; (v) the ultimate supervision of the persons entrusted with the management of the company, in particular with respect to their compliance with applicable law, the Articles, regulations and directives; (vi) the preparation of the annual report as well as the preparation of shareholders' meetings and the implementation of their resolutions; (vii) notification of the judge in case of over-indebtedness; (viii) the adoption of resolutions concerning increases in share capital to the extent that such power is vested in the Board (Article 651 (4) CO), including resolutions concerning the confirmation of capital increases and respective amendments to the Articles, and (ix) the non-transferable and inalienable duties and powers of the Board pursuant to the Swiss Federal Merger Act (*Fusionsgesetz*) and any other applicable law.

In accordance with and subject to Swiss law, the Articles and the Organisational Regulations, the Board has delegated the company's management to the Chief Executive Officer of the company (the "CEO"), who leads the top tier of the company's executive management (the "Executive Management").

3. **Board Committees**

The Board has established a compensation and nomination committee (the "Compensation Committee" or "CC") and a finance and audit committee (the "Finance and Audit Committee" or "FAC").

a. **Compensation Committee**

The members of the Compensation Committee are appointed by the Board. The Compensation Committee lays down guidelines for selecting candidates for election or re-election as members of the Board, its committees and the CEO, and makes arrangements to select such candidates.

Further, the Compensation Committee lays down guidelines for the remuneration of the members of the Board, the CEO and Executive Management, and submits these to the Board for approval. It makes recommendations to the Board as to the overall package of remuneration, in order to attract and retain persons with the necessary skills and character.

b. **Finance and Audit Committee**

The members of the Finance and Audit Committee are appointed by the Board. The Finance and Audit Committee assists the Board in fulfilling its duties to supervise management. In particular, it has the following duties and responsibilities: (i) assess the effectiveness and independence of the external auditors (the statutory auditors and group auditors) and the internal auditors; (ii) assess the effectiveness of the cooperation between external and internal auditors; (iii) make a quality assessment of the risk management framework and the implementation thereof and gauge whether compliance with rules and regulations is being adequately monitored within the company; (iv) decide upon audit work outside the regular audit of the yearly accounts, including operational audits and system audits; (v) review the individual and consolidated financial statements and discuss these with the Chief Financial Officer and, separately with the responsible person(s) of the external auditors; and (vi) decide whether the statutory and consolidated financial statements are to be recommended to the Board for presentation to the AGM.

4. **Members of the Board**

The following table sets forth the name, function and committee membership of each Director as at the end of 2017.

Other than disclosed below, none of the Directors has any significant business connections with the company.

Name	Function	Committee memberships	First elected	End of current period
Argeris ("Jerry") M. Karabelas	Chairman	CC	2013	2018
Kuno Sommer	Vice-Chairman	CC (Chair)	2012	2018
Bernard Bollag	Member	FAC (Chair)	2013	2018
Jean-Jacques Garaud	Member	CC	2013	2018
Silvio Inderbitzin	Member	FAC	2016	2018
Jean-Pierre Obrecht	Member		1996	2018
Andreas Wallnöfer	Member		2017	2018

Board of Directors

Argeris (“Jerry”) M. Karabelas, Ph.D.
CHAIRMAN

Jerry Karabelas is a Partner at Care Capital LLC. Previous to this position, Dr. Karabelas founded the Novartis BioVenture Fund. He was also the former Head of Global Healthcare and Executive Committee Member, Novartis. Prior to that he was former Executive VP and Head of Global Pharmaceuticals, SmithKline Beecham. He was also a Professor of Pharmacokinetics. Dr. Karabelas has founded several companies. He is a current partner, Care Capital LLC and a current member of the Board of Valeant Pharma, Regenxbio and Braeburn Pharma. He is former Chairman of Human Genome Sciences, Vanda Pharmaceuticals Inc., Renovo, NitroMed Inc., and SkyePharma plc.
Dr. Karabelas holds a Ph.D. in Pharmaceutical Sciences and Pharmacokinetics from the Massachusetts College of Pharmacy and a Bachelor of Sciences in Biochemistry from the University of New Hampshire.

Kuno Sommer, Ph.D.
VICE-CHAIRMAN

Kuno Sommer, today focuses on active board memberships in the life sciences sector as non-executive member. He became Chairman of the Board of the Bachem Group starting in 2012. In his last operational role he headed the contract research division of Harlan Laboratories Ltd. From 2000 until 2006 he was CEO of Berna Biotech Ltd, which was sold to Crucell N.V. in 2006 (today Johnson & Johnson). Starting in 1986 at F. Hoffmann-La Roche Ltd. he worked in various functions until 1999 and spent 4 years in the US. In his last position at Roche he became a member of the Executive Committee, responsible for the Flavours and Fragrances division (today Givaudan Ltd).
Dr. Sommer holds a Ph.D. in Business Administration from the University of Basel as well as an MBA.

Corporate Governance

Bernard Bollag, MBA

Bernard Bollag is a senior finance executive with broad experience in corporate finance and capital markets. Bernard was CFO in private equity, until 2012, with HomeSun in the UK Renewable Energy sector, as well as internationally from 2006, across a broad portfolio of sectors and investments. Prior to that, Bernard was with Syngenta. As its Group Treasurer, Bernard led the company’s capital markets and bank funding after the spin-off from Novartis and Astra-Zeneca, and was responsible for financial risk across the Group. Bernard started his career with Unisys, rising through a typical international finance path, in roles of increasing responsibility spanning finance, operations and funding. In 2012, Bernard founded Beaufort Capital as a boutique advising HNW investors in private equity.
Bernard Bollag holds an MBA in Finance from the Columbia Business School in New York and a BA in Economics from the Bar-Ilan University of Tel-Aviv.

Jean-Jacques Garaud, M.D.*

Jean-Jacques Garaud served until 2012 as Head of Roche Pharma Research & Early Development and as a Member of the Enlarged Roche Corporate Executive Committee. Prior to joining F. Hoffmann-La Roche Ltd. in 2007, he was the Global Head of Exploratory Development at Novartis Pharma in Switzerland. From 1985 until 2005, he worked in clinical research with Marion Merrell Dow, Rhône-Poulenc Rorer, Schering-Plough and Novartis Pharma USA. He was Assistant Attaché in Infectious Diseases and Intensive Care Medicine at the Claude Bernard Hospital in Paris from 1981 to 1985. He is the founder and CEO of Inotrem, a French biotech company, and Board member of Circassia in the UK as well as Enyo in France.
He earned his medical degree as well as a diploma in Tropical Medicine, Public Health & Epidemiology from the University of Paris.

**Jean-Jacques Garaud is not standing for re-election for the business year 2018. The Proposed replacement at the AGM is Frank T. Weber, M.D.*

Silvio Inderbitzin, Ph.D.

Silvio Inderbitzin is active as a board member and investor in various start-up and small to mid-sized life science companies in Switzerland. In addition, he has an operational function as CEO (besides Chairman) at the new on the market dermatological company Mavena International Ltd. Beforehand he served a privately-held 450-employee pharmaceutical company Spirig Pharma Ltd. where he first joined as Head of QA, was elected to Technical Director, member of the Corporate Management Team, Board of Directors and also became a co-owner. Prior to the successful sale of the company in 2012 / 2013, he served as CEO and was responsible for its foreign subsidiaries. He has his origin in pharmaceutical manufacturing.
Dr. Inderbitzin studied Pharmacy at the University of Berne, holds a Ph.D. in Pharmacology from the University of Zurich / ETH and obtained an Executive MBA from the University of St. Gallen.

Jean-Pierre Obrecht, Ph.D.

Jean-Pierre Obrecht, Ph.D. is co-founder of Polyphor Ltd. and has been its CEO for more than 18 years, from the company's inception until March 2015. Under his leadership the proprietary Macrocycle Technology Platform was developed and business relations were established with companies in Japan, USA and Europe. Three own product candidates were advanced into clinical development and Polyphor evolved from a drug discovery chemistry service provider into a clinical stage pharma company supported by a strong and broad investor base. Prior to that Jean-Pierre Obrecht was Head Logistics Chemicals at F. Hoffmann-Roche Pharma in Basel. Before that he was head of the production and engineering department and member of the management team of Dr. R. Maag AG, a former affiliate of Roche and later Ciba-Geigy.
Jean-Pierre Obrecht obtained his Ph.D. in Natural Sciences (chemistry) from the ETH Zurich and an Executive MBA degree from the University St. Gallen (NDU / HSG).

Corporate Governance

Andreas Wallnöfer, Ph.D., MBA

Andreas Wallnöfer, Ph.D., MBA served at F. Hoffmann-La Roche Roche Ltd. from 2007 to 2009 as Global Head of Clinical Research & Exploratory Development and Senior Vice President. After Roche's acquisition of Genentech he was appointed in 2010 as Head of Roche pRED Development and, in addition, in 2012 he took on the role of Global Head of Cardiovascular & Metabolism Disease (CVM). After the company decided to exit CVM for strategic reasons, he left Roche and joined in 2016 BioMedPartners. Subsequently, he acted as interim Head of Development at Polyphor until spring 2017 and directed the company's lead project successfully through end of Phase 2 regulatory meetings.
Dr. Wallnöfer holds a Ph.D. in Pharmacology from the University of Basel, trained as Clinical Pharmacologist at the University Hospital of Leiden and holds an Executive MBA from IMD Lausanne.

B. Executive Management

1. General information

In accordance with Swiss law, the Articles and the Organisational Regulations and subject to those matters that lie within the responsibility of the Board by law, the Articles and the Organisational Regulations, the Board has delegated the executive management of the company to the CEO. The CEO also chairs the Executive Management.

As per the Organisational Regulations, the Executive Management consists of the CEO, the Chief Financial Officer (the "CFO") and certain other members who are responsible for specific business units or functions identified by the Board. As of the end of 2017, such other members were the Chief Scientific Officer (the "CSO"), the Chief Medical & Development Officer (the "CMO"), the Head Chemistry, the Head of Drug Discovery and Head Biostructural, ADMET and Technical Service. The CEO is appointed by the Board upon proposal by the CC. The other members of the Executive Management are appointed by the Board upon proposal by the CEO.

The CEO is responsible for, among other things, initiating and implementing the strategy of the company, managing and monitoring his direct reports, including the other members of the Executive Management, preparing, convening and chairing meetings of the Executive Management, deciding in the case of overlapping interests of business or functional units, and updating the Chairman and the Board on the course of business of the company.

The CFO is responsible for, among other things, the company's finances and administration, in particular for the implementation and monitoring of the principles and directives regarding financial planning, accounting and financial control of the company, appropriate financing of the company and its units and subsidiaries and establishing the necessary control mechanisms, including risk management.

Under the supervision of the Board and under the leadership of the CEO, the Executive Management conducts the operational management of the company in accordance with the Organisational Regulations and the function chart. The members of the Executive Management report to the CEO.

Corporate Governance

2. Members of the Executive Management

The following table sets forth the name and principal position of each member of the Executive Management as of the end of 2017.

Name	Appointed	Position
Giacomo Di Nepi	2016	CEO
Debra Barker	2017	CMO
Daniel Obrecht	1996	CSO
Kalina Scott	2017	CFO
Marc Thommen	2007	Head Chemistry
Steffen Weinbrenner	2011	Head of Drug Discovery
Peter Zbinden	2008	Head Biostructural, ADMET and Technical Service

Following the restructuring of the Collaboration Services business and effective as of January 2018, the Executive Management consists of the following six members: Giacomo Di Nepi (CEO), Debra Barker (CMO), Daniel Obrecht (CSO), Kalina Scott (CFO), Helmut Kessmann (Head Business Development) and Franziska Müller (Head Human Resources).

Executive Management

Giacomo Di Nepi
CHIEF EXECUTIVE OFFICER

Giacomo Di Nepi currently serves on the boards of Geneuro (GNRO.PA), Kuros Biosciences (KURN.SW) and NTC, a privately held company. Before he was Executive Vice President and General Manager, Europe, for InterMune Inc., where he launched an orphan drug and built a USD 140 million and 200-person business from scratch – until the acquisition of InterMune by Roche for USD 8.3bn. Prior to that he held senior leadership positions with Takeda and Novartis, where he was also a member of the Pharma Executive Committee, and was a Partner with McKinsey & Co.

Giacomo Di Nepi holds a degree in Economics from Bocconi University, Milan, Italy and an MBA from INSEAD, Fontainebleau, France.

Debra Barker, M.D.
CHIEF MEDICAL AND DEVELOPMENT OFFICER

Dr. Debra Barker is a seasoned medical expert in clinical development and has extensive experience in infectious and respiratory diseases and in immunology. She joined Polyphor in May 2017 from Novartis, where she held various senior management positions as Global Head of Medical Affairs for the ophthalmology business and Head of Development for infectious diseases, transplants and immunology. From 1995 to 2001 she worked in clinical and commercial roles for Roche, and previously for SmithKline Beecham and Knoll / BASF.

Dr. Debra Barker received an MD from Queens' College, Cambridge, UK, and an MSc in immunology from King's College, London, UK. Dr. Barker is a British and Swiss dual national.

Corporate Governance

Daniel Obrecht, Ph.D.
CHIEF SCIENTIFIC OFFICER AND CO-FOUNDER

Daniel Obrecht spent 11 years at the Central Research Laboratories of Roche, Basel. In his previous position he was Head of the Combinatorial Chemistry Group.

Dr. Daniel Obrecht obtained his Ph.D. in Chemistry from the University of Zurich in 1985 under the supervision of Prof. H. Heimgartner, after which he was associated with Prof. R. E. Ireland at Caltech as a postdoctoral fellow for 2 years. Dr. Daniel Obrecht is the author of numerous publications and books and holds several patents in the field of pharmaceuticals. He was appointed Roche Lecturer in 1993.

Kalina Scott
CHIEF FINANCIAL OFFICER

Kalina Scott joined from Bank am Bellevue in Zurich, where she was Managing Director Corporate Finance, responsible for transactions in the fields of mergers & acquisitions, capital markets and private placements. A seasoned professional with over 20 years of work experience in investment banking and corporate finance, she started her career at UBS in Zurich and London, working in structured finance and credit risk management, followed by leveraged finance as well as mergers & acquisitions. As Director of Corporate Finance at KPMG Zurich, she created a corporate defense offering and supported the IPO advisory business of KPMG.

Kalina Scott studied Business and Economics at the University of Leipzig, Germany, and holds a Bachelor of Business Administration from the Sofia University in Bulgaria.

Marc Thommen, Ph.D.

HEAD OF CHEMISTRY

Following his postdoctoral studies, Dr. Marc Thommen worked at the catalysis and process R&D department of Novartis in Basel as lab head. In the course of the spin-off of the Scientific Services department in 1999, which led to the foundation of Solvias AG, he managed numerous customer projects associated with preclinical and clinical material supply, and later led the catalysis and chiral ligand commercialization project. In 2005, he was appointed head of product management of Solvias before joining Polyphor as head of Chemistry in 2007.

Dr. Marc Thommen received his Ph.D. in Chemistry from the University of Bern in 1995 under the direction of Prof. Dr. Reinhard Keese. From 1996 to 1997 he studied in the group of Prof. Dr. Barry M. Trost at Stanford University, USA as a postdoctoral fellow.

Steffen Weinbrenner, Ph.D.

HEAD OF DRUG DISCOVERY

Steffen Weinbrenner joined the company in 2011 as Head of Project and Alliance Management from Nycomed, where he held various management positions as Head of Discovery Technologies and Head of Global Medicinal Chemistry, overseeing synthetic chemistry, chemical outsourcing, molecular modeling and drug design at sites in Konstanz (Germany) and Mumbai (India). Prior to that he served as Head of Department Lead Finding Chemistry at Altana AG. From 1996 to 2003 he worked as research scientist and project leader in the field Medicinal Chemistry on several drug discovery projects at Altana Pharma AG and Byk Gulden GmbH.

He obtained his Ph.D. on the total synthesis of cyclopeptidic natural products in 1995 under the supervision of Prof. Dr. U. Schmidt at the University of Stuttgart.

Peter Zbinden, Ph.D.

HEAD BIOSTRUCTURAL, ADMET AND TECHNICAL SERVICE

Peter Zbinden joined Polyphor in 2008. He is responsible for structural design and molecular modeling, X-ray and 2D-NMR structure determination, LC-M analysis, early in-vitro ADMET and PK, compound logistics and reagent ordering, information management and IT.

From 2006–2007 he was Director Chemistry and Information Management at Biofocus DPI AG (former Discovery Partners International AG). From 2000–2006 he was VP Information Management and Chemistry Libraries at Discovery Partners International AG (former Discovery Technologies AG). From 1997–1999 he was Head Information Services at Discovery Technologies AG. From 1994–1997 he was Research Associate at Biografics Laboratory 3R (Basle) where he developed scientific software and new scientific concepts in the context of quantitative SAR. He also acquired and managed customer projects with industrial and academic partners. From 1992–1994 he was Application Scientist at Molecular Simulations Inc. (Basle) and responsible for customer support and training of all SW applications in Life Sciences.

He obtained his Ph.D. in Chemistry in 1992 at the ETH Zürich under the supervision of Prof. Dr. M. Dobler, Prof. Dr. H. Dutler and Prof. Dr. W. van Gunsteren.

C. Compensation

1. Compensation principles and elements

The compensation of the Directors consists of fixed compensation and the compensation of the members of the Executive Management consists of fixed and variable compensation elements as well as further compensation elements and benefits. The total compensation takes into account the position and level of responsibility of the recipient.

The performance-related remuneration depends on the company's business success and the individual performance of the member of the Executive Management based on the achievement of predetermined targets during a business year. The Board determines annually at the beginning of each relevant business year the decisive targets and their weighting upon proposal by the Compensation Committee. The amount of the performance-related remuneration for each member of the Executive Management is determined by the Board upon proposal of the Compensation Committee.

2. Incentive and equity-based plans

The company has an Employee Stock Option Plan (the "ESOP") which was established in 2013 and amended in 2017. Under the ESOP, the selected managers, employees, members of the Board and consultants and advisors of the company or any affiliate it controls (together the "Participants") may be provided by the Board with an opportunity to obtain stock options on fully paid-in Shares, providing an increased incentive for participants to make significant and extraordinary contributions to the long term performance and growth of the company. The granting of options is evidenced by an option agreement and options are granted for a maximum period of ten years after the ESOP becomes effective. Options granted under the ESOP are generally subject to four year vesting with 25 percent of options vesting after the first twelve full calendar months after the grant date and the remainder of such granted options vesting in twelve quarterly instalments thereafter. The Board establishes the exercise period, during which the options may be exercised. The options may be exercised at any time within the exercise period, entitling the participant to one option to purchase one Share but will expire after the exercise period without compensation. Upon exercise of the option, the options are exchanged for Shares. In case of an initial public offering of Shares ("IPO"), the Board may impose on any Shares granted under the ESOP any additional restrictions, including, but not limited to, lock-up periods, as may be reasonably requested by the Board to enhance the success of the IPO.

In case of leaving participants due to retirement, disability, death, resignation or without cause, only those options relating to which the vesting period has already lapsed (plus in some cases extra instalments) may be exercised. The Board may shorten the exercise period to ninety days after the termination date in case of termination due to retirement, disability, death. The Board may extend the exercise period to ninety days period until the end of the exercise period, in case of termination without cause (passive good leaver) or resignation (active good leaver). In case of termination with cause (bad leaver) and forfeiture provisions, any options not yet exercised are not exercisable anymore and shall be terminated and forfeited. In the event of a change of control, all options vest immediately and fully upon completion of a change of control of the company (accelerated vesting). In 2017 no Shares were purchased under the ESOP.

Corporate Governance

D. Ownership of Shares and options

1. Directors

The table below shows the number of Shares and options that each Director owned at the end of 2017.

Name	Shares	Options
Argeris ("Jerry") M. Karabelas	2'999	0
Kuno Sommer	0	0
Bernard Bollag	5'240	0
Jean-Jacques Garaud	0	1'250
Silvio Inderbitzin	17'744	0
Jean-Pierre Obrecht	144'700	3'750

2. Executive Management

The table below shows the number of Shares and options that each member of the Executive Management owned as at the end of 2017.

Name	Shares	Options
Giacomo Di Nepi	2'400	25'000
Debra Barker	0	7'500
Daniel Obrecht	200'870	5'000
Kalina Scott	0	5'000
Marc Thommen	5'220	1'500
Steffen Weinbrenner	3'600	1'500
Peter Zbinden	5'050	1'500

Financial Report 2017

Results of operations

FOCUSING ON THE PHARMA BUSINESS

Segmentation and Restructuring

Until December 31, 2016, we operated in one business unit and operating segment, focusing on the research and development and prospective commercialization of macrocyclic drugs addressing unmet medical needs. An internal reorganization in the financial year 2017 resulted in the establishment of two strategic business units, "Pharma" and "Collaboration Services". Such business units offer different products and collaborations, are managed separately because they require different expertise and marketing strategies and are considered to be separate reportable operating segments.

• **Pharma:** Our Pharma segment predominantly comprises the research, development and potential commercialization, out-licensing or partial out-licensing of our three product candidates, the further development of the OMPTA platform, as well as the sales of Polyphor Libraries (i.e. the capitalized compounds of our macrocycle platform).

• **Collaboration Services:** Our Collaboration Services segment comprises contractual research collaborations with pharma companies, involving support by our employees of research and drug optimization activities performed at our laboratories. As is customary in research collaborations, an industry partner selects the therapeutic targets and we apply our macrocycle platform to find and optimize hits and leads into preclinical candidates. The industry partner pays us an access fee for the use of our macrocycle platform and funds our employees working on the program. In addition, we are eligible for future preclinical and clinical milestone payments.

The development of the macrocycle platform (PEMfinder® and MacroFinder®) (also referred to as Polyphor Library) is part of our Pharma segment. This technology platform can be provided to third parties for screening at their premises and can also be used for the extension of our innovative product pipeline. PEMfinder® and MacroFinder® are capitalized and the respective external revenues which represent Polyphor Library Sales are included in our Pharma segment. On the other hand, the "production" costs for the Polyphor Library, consisting mainly of personnel and materials expenses, are included in our Collaboration Services segment and charged to the Pharma segment on an arm's length basis.

Following the strategic review of our business operations in 2017, we concluded that our Collaboration Services segment was and is not financially self-sustainable. After careful evaluation of the alternatives and completion of a consultation process with our employees, the Collaboration Services business was discontinued. We expect the restructuring of the Collaboration Services segment to be completed by the third quarter of 2018 and do not expect to generate any further revenues or losses from such operating segment in the future.

As part of the restructuring process, 35 employees predominantly in the Collaboration Services segment, accounting for approximately 35% of our workforce, were laid off. The majority of them left the Company by December 31, 2017 with seven employees remaining on the Company's payroll until August 2018 in order to fulfill contractual obligations. As a result of the discontinuation of our Collaboration Services segment, we recognized a provision of CHF 1.1 million for expected restructuring costs during the financial year ending December 31, 2018, including mainly employee termination benefits, which are based on individual termination agreements concluded with the individual employees. In addition, we recognized an impairment of our Polyphor Library in the amount of CHF 5.7 million reflecting the discontinuation of the use of the Polyphor Library in the Collaboration Services segment and a gain of CHF 3.1 million included in the pension expenses reflecting the reduction of our pension liability due to our reduced workforce following the restructuring.

Revenues

In the period under review, we pursued our own research and development programs for our three product candidates: murepavadin, balixafortide and POL6014 as well as the OMPTA platform in our Pharma segment. We also leveraged our macrocycle-based discovery platform to assist science-based pharmaceutical companies in identifying novel compounds against drug targets of their interest in our Collaboration Services segment. In the three years ended December 31, 2017, 2016 and 2015, on a cumulative basis, we recognized revenues of CHF 20.6 million.

In the Pharma business segment, our revenues consisted primarily of third party funding and milestone payments. As such, our revenue in this business segment is tied to discontinuous events and therefore is non-recurring. Based on our past experience, we expect the discontinuous pattern in revenue generation to continue in our Pharma segment in the future, until any of our product candidates receive market approval and can be commercialized, either by ourselves, or by a partner from whom we would receive regular payments, such as royalties or sales milestones.

In our Collaboration Services business segment, our revenues mainly consisted of payments for our employees designated to a specific collaboration, recharging of third party costs and milestone payments for reaching specified optimization goals.

Costs

In the three years ended December 31, 2017, 2016 and 2015, on a cumulative basis, we incurred CHF 118.4 million as total net operating expenses (incl. depreciation and amortization). Our operating expenses consist primarily of research and development expenses representing CHF 109.7 million in total during the period under review.

Our expenses reflect, to a large extent the stage and level of our clinical and preclinical research and development activities. In general, the costs of development of a product candidate increase with the advancement of its development stage until it enters a review period and final approval. We anticipate that our operating expenses will increase as compared to prior periods in connection with our ongoing activities, particularly due to the Phase III clinical development of our lead product candidate murepavadin (POL7080). We expect that costs of third party service providers, in particular the CRO we have appointed for conducting the Phase III clinical trials for murepavadin, will be a significant cost factor in the future.

In the beginning of 2018, following the restructuring of the Collaboration Services business, we introduced cost centers and allocated cost responsibilities to the individual functions. We also implemented rigorous cost monitoring and cost reduction program, aiming to reduce the level of ongoing steady-state operating costs.

Consolidated statements of financial position
in CHF

	Notes	31.12.2017	31.12.2016	31.12.2015
Assets				
Current assets				
Cash and cash equivalents	4	24'559'631	14'595'095	37'797'045
Trade accounts receivable	5	620'457	304'453	843'125
Other accounts receivable	5	1'358'862	1'245'797	1'050'780
Prepaid expenses	6	1'083'069	985'405	439'843
Total current assets		**27'622'018**	**17'130'750**	**40'130'793**
Non-current assets				
Property, plant and equipment (PPE)	7	4'359'677	5'242'228	6'154'859
Intangible assets	8	48'090	78'880	75'967
Technology platforms	9	7'779'400	13'552'725	11'762'000
Rent deposit	5	447'221	447'159	447'022
Total non-current assets		**12'634'388**	**19'320'992**	**18'439'848**
Total Assets		**40'256'406**	**36'451'742**	**58'570'641**
Liabilities and shareholders' equity				
Current liabilities				
Trade accounts payable	10	4'071'858	2'958'388	3'455'664
Other accounts payable	10	545'913	225'697	114'108
Prepayments	10	570'000	1'060'000	0
Current portion of debt	13	574'713	545'025	516'873
Deferred income / revenue	10	340'741	68'782	220'882
Accrued expenses	11	4'146'927	2'683'708	2'745'121
Short-term provision	12	1'130'159	0	0
Total current liabilities		**11'380'310**	**7'541'601**	**7'052'648**
Non-current liabilities				
Pension liabilities	17	7'289'655	8'853'189	8'216'359
Non-current portion of debt	13	4'258'074	3'326'305	3'871'330
Total non-current liabilities		**11'547'729**	**12'179'494**	**12'087'689**
Total Liabilities		**22'928'040**	**19'721'095**	**19'140'337**
Shareholders' equity				
Share capital	14	13'365'922	11'424'200	11'424'200
Additional paid-in capital		209'157'972	171'696'977	171'696'977
Other reserves	15	6'963'205	5'630'124	4'180'525
Cumulative translation differences		159	-169	-16
Accumulated deficit		-212'158'891	-172'020'484	-147'871'382
Total shareholders' equity		**17'328'367**	**16'730'647**	**39'430'304**
Total liabilities and shareholders' equity		**40'256'406**	**36'451'742**	**58'570'641**

Consolidated income statements for the years ending December 31
in CHF

	Notes	2017	2016	2015
Research and development contributions		4'297'931	6'071'714	4'326'801
Polyphor Library sales		1'040	367'804	387'787
Upfront and milestone payments		0	2'211'250	2'958'000
Total revenue	3	**4'298'970**	**8'650'768**	**7'672'588**
Capitalized costs of technology platforms		1'992'600	3'474'900	2'238'650
Other income		100'000	0	0
Research and development		-39'195'178	-30'871'203	-39'652'808
Marketing and sales		-2'109'372	-1'615'957	-1'700'683
General and administrative		-3'735'270	-3'552'802	-3'772'933
Net operating expenses	16	**-42'947'221**	**-32'565'061**	**-42'887'774**
Operating loss		**-38'648'251**	**-23'914'293**	**-35'215'186**
Financial income		30'733	27'381	44'366
Financial expenses		-446'425	-226'002	-255'560
Net foreign exchange gain / (loss)		-31'514	-24'724	346'472
Net loss for the period		**-39'095'457**	**-24'137'639**	**-35'079'908**
Net loss per share after split (basic)	20	-6.32	-4.23	-6.14
Net loss per share split (diluted)	20	-6.32	-4.23	-6.14

Consolidated statements of comprehensive income for the years ending December 31
in CHF

	Notes	2017	2016	2015
Net loss for the period		**-39'095'457**	**-24'137'639**	**-35'079'908**
Other comprehensive loss to be reclassified to profit or loss in subsequent periods:				
Cumulative translation differences		-328	-153	-123
Other comprehensive loss not to be reclassified to profit or loss in subsequent periods:				
Remeasurement of pension liabilities	17	-1'042'950	-11'462	-129'817
Other comprehensive loss		**-1'043'278**	**-11'615**	**-129'940**
Total comprehensive loss		**-40'138'735**	**-24'149'254**	**-35'209'848**

Consolidated statements of cash flows for the years ending December 31
in CHF

	Notes	2017	2016	2015
Cash flows from operating activities				
Cash receipts from customers and partners		3'751'798	9'902'187	7'825'373
Cash paid to employees and suppliers of material and services		-25'705'161	-26'906'920	-34'342'329
Cash paid for rent		-1'201'401	-1'134'479	-1'176'025
Cash paid for repair and maintenance		-438'492	-533'878	-507'570
Cash paid for patents and trademarks		-1'192'854	-1'259'708	-1'094'706
Cash paid for information technology		-583'108	-576'525	-573'546
Cash paid for marketing and travel expenses		-932'763	-555'517	-495'442
Other net operational expenses		-3'606'956	-1'207'867	-1'051'677
Interest received		30'733	27'381	44'366
Capitalised costs of Technology Platforms		1'992'600	3'474'900	2'238'650
Net cash flow from operating activities		**-27'885'605**	**-18'770'428**	**-29'132'906**
Cash flows from investing activities				
Sale of financial assets	7	0	0	20'000'000
Purchase of property, plant and equipment and intangible assets	7,8	-151'653	-215'149	-872'576
Capitalised costs of Technology Platforms		-1'992'600	-3'474'900	-2'238'650
Net cash flow from investing activities		**-2'144'253**	**-3'690'049**	**16'888'774**
Cash flows from financing activities				
Proceeds from issuance of share capital	14	39'818'904	0	0
Payment of capital increase cost		-416'186	0	0
Proceeds from convertible loan 2017		1'326'311	0	0
Repayment of debt	13	-545'025	-516'873	-490'176
Interest paid on debt	13	-192'658	-220'809	-247'506
Net cash flow from financing activities		**39'991'345**	**-737'682**	**-737'682**
Net (de-) / increase in cash and cash equivalents		9'961'487	-23'198'160	-12'981'814
Effects of exchange rate changes on cash and cash equivalents		3'048	-3'790	-67'348
Cash and cash equivalents as of January 1	4	14'595'095	37'797'045	50'846'207
Cash and cash equivalents as of December 31	4	**24'559'631**	**14'595'095**	**37'797'045**

In the previous years the cash out flows relating to the capitalised cost of technology platforms were erroneously presented as part of the cash flows from operating activities instead of from investing activities. Prior year figures have been correspondently restated.

Consolidated statements of changes in shareholders' equity for the years ending December 31
in CHF

	Share Capital Common shares (Note 14)	Share Capital Common B-shares (Note 14)	Paid-in capital	Other reserves	Cumulative translation differences	Accumulated deficit	Total Equity
Balance as of January 1, 2015	**10'820'400**	**603'800**	**171'696'977**	**3'517'814**	**107**	**-112'661'657**	**73'977'441**
Net loss for the period	–	–	–	–	–	-35'079'908	-35'079'908
Other comprehensive income	–	–	–	–	-123	-129'817	-129'940
Total comprehensive income	**–**	**–**	**–**	**–**	**-123**	**-35'209'725**	**-35'209'848**
Stock option plan (note 15)	–	–	–	662'711	–	–	662'711
Balance as of December 31, 2015	**10'820'400**	**603'800**	**171'696'977**	**4'180'525**	**-16**	**-147'871'382**	**39'430'304**
Balance as of January 1, 2016	**10'820'400**	**603'800**	**171'696'977**	**4'180'525**	**-16**	**-147'871'382**	**39'430'304**
Net loss for the period	–	–	–	–	–	-24'137'639	-24'137'639
Other comprehensive income	–	–	–	–	-153	-11'462	-11'615
Total comprehensive income	**–**	**–**	**–**	**–**	**-153**	**-24'149'101**	**-24'149'254**
Stock option plan (note 15)	–	–	–	1'449'598	–	–	1'449'598
Balance as of December 31, 2016	**10'820'400**	**603'800**	**171'696'977**	**5'630'123**	**-169**	**-172'020'484**	**16'730'647**
Balance as of January 1, 2017	**10'820'400**	**603'800**	**171'696'977**	**5'630'124**	**-169**	**-172'020'484**	**16'730'647**
Net loss for the period	–	–	–	–	–	-39'095'457	-39'095'457
Other comprehensive loss	–	–	–	–	328	-1'042'950	-1'042'622
Total comprehensive income	**–**	**–**	**–**	**–**	**328**	**-40'138'407**	**-40'138'080**
Issuance of share capital	1'941'722	–	37'877'182	–	–	–	39'818'904
Cost of capital increase	–	–	-416'186	–	–	–	-416'186
Stock option plan (note 15)	–	–	–	1'333'081	–	–	1'333'081
Balance as of December 31, 2017	**12'762'122**	**603'800**	**209'157'972**	**6'963'205**	**159**	**-212'158'891**	**17'328'367**

1. General information

Polyphor Ltd. ("Polyphor" or the "Company", and together with its subsidiary "the Group") is a clinical stage, Swiss specialty pharma company, focused on the development of macrocycle drugs that address antibiotic resistance and other severe diseases. The company's lead drug candidates include:

- Murepavadin (POL7080, entering Phase III / pivotal registration program), a precision Outer Membrane Protein Targeting Antibiotic (OMPTA) against *Pseudomonas aeruginosa*.
- Balixafortide (POL6326, in Phase Ib), an antagonist of the chemokine receptor CXCR4 for combination treatment in oncology.
- POL6014 (in Phase Ib), an inhaled inhibitor of neutrophil elastase for the treatment of cystic fibrosis and other neutrophilic lung diseases.

In addition, Polyphor has discovered and is developing the OMPTA class to address infections caused by difficult-to-treat, resistant Gram-negative pathogens. Polyphor also owns a proprietary macrocycle technology platform used for the discovery of new drugs that can address difficult targets.

The legal domicile of the Company is:

POLYPHOR Ltd
Hegenheimermattweg 125
CH-4123 Allschwil
Switzerland

2. Summary of significant accounting policies

2.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The accounting policies set forth below have been consistently applied to all years presented.
The financial statements have been prepared on a historic cost basis and are presented in Swiss Francs (CHF), rounded to the nearest Swiss Franc. Due to rounding, numbers presented throughout this report may not add up precisely to the totals provided. All ratios and variances are calculated using the underlying amount rather than the presented rounded amount.
The financial statements were authorised for issue by the Company's Board of Directors on February 12, 2018.

2.2 Functional and presentation currency

These consolidated financial statements are presented in Swiss Francs (CHF), which is the Company's functional currency.

2.3 Consolidation

The consolidated financial statements include the Company and its subsidiary. Control exists when the investor is exposed, or has rights, to variable returns from its investment with the investee and has the ability to affect those returns through its power over the investee. Control is normally evidenced when the Company owns, either directly or indirectly, more than 50% of the voting rights or potential voting rights of a company's share capital that are currently exercisable. The subsidiary is consolidated from the date on which effective control is transferred to the Group and is deconsolidated from the date control ceases.
All inter-company balances, transactions and unrealized gains on transactions have been eliminated in consolidation. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

During the year under review the scope of consolidation remained unchanged. The following entities are within the scope of consolidation:

Company	Registered	Currency	Nominal Capital	Equity Interest
Polyphor Ltd.	Basel	CHF	13'365'922	
Polyphor UK	United Kingdom	GBP	1'000	100%

2.4 Adoption of new accounting standards and changes in accounting policies

The following new and amended IFRS and IFRIC interpretations relevant for the Group have been adopted during the year.

Effective for annual periods ending December 31, 2017 and thereafter:

- Annual improvements to IFRSs 2012–2014 Cycle. Effective for annual periods beginning on or after July 1, 2016.
- Annual improvements to IFRSs 2014–2016 Cycle. Effective for annual periods beginning on or after January 1, 2017 or 2018.
- Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealized Losses. Effective for annual periods beginning on or after January 1, 2017.
- Amendments to IAS 7 – Disclosure Initiative. Effective for annual periods beginning on or after January 1, 2017.

The adoption of the standards and interpretations did not have any effect on the financial statements of the Company, other than the amendment to IAS 7 which has led to additional disclosures, refer to Note 21.4 Liquidity Risk.
The Group will apply the following changes potentially relevant for the Group for the first time as of the date stated in the respective standard. Currently being evaluated are the following relevant standards and interpretations:

- IFRS 9 – Financial instruments. Effective for annual periods beginning on or after January 1, 2018.
- IFRS 15 – Revenue from Contracts with Customers. Effective for annual periods beginning on or after January 1, 2018. The Group does not expect IFRS 15 to have a significant impact on its consolidated financial statements and will implement the new standard on January 1, 2018.
- IFRS 16 – Leases. Effective for annual periods beginning on or after January 1, 2019.
- IFRIC 22 – Foreign Currency Transactions and Advance Consideration.

The Group is currently analysing in detail the changes to the before mentioned accounting standards. The impact on the consolidated financial statements of the changes are not expected to be material.

2.5 Significant accounting judgement, estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the affected assets or liabilities in future periods.

Estimates and assumptions
The key assumptions at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year relate to the valuation of technology platforms (note 2.13), valuation of Convertible loan (note 2.16) and valuation of options granted during the year under the employee stock option plan (note 2.20).

The cost of defined benefit pension plans is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.
The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Company. Such changes are reflected in the assumptions when they occur.

2.6 Foreign currency translation

Each company in the Group uses its functional currency, and items in the financial statements of each entity are measured using that functional currency.
Foreign currency transactions are translated in the functional currency at the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, as well as from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.
Upon consolidation, assets and liabilities of the subsidiary reporting in foreign currency are translated into Swiss Francs using the exchange rate at the reporting date. Its statements of financial performance are translated at the average exchange rates of the reporting year.

The exchange rates for the most significant foreign currencies are as follows:

	Income statement in CHF average rates			Balance sheet in CHF year-end rates		
	2017	2016	2015	2017	2016	2015
1 USD	0.9850	0.9866	0.9626	0.9761	1.0189	0.9922
1 EUR	1.1127	1.0890	1.0682	1.1693	1.0736	1.0829
1 GBP	1.2717	1.3434	1.4713	1.3169	1.2535	1.4697

2.7 Cash and cash equivalents

This item includes cash at bank and on hand, current time deposits held with banks with original maturities up to 3 months and other short term highly liquid investments with original maturities up to 3 months. Bank overdrafts (if any) are presented separately within current liabilities.

2.8 Financial assets

Polyphor's financial assets comprise loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when Polyphor provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for those with maturities longer than 12 months after the balance sheet date in which case they are classified as non-current assets. Loans and receivables are included in trade accounts receivable in current assets and as loans to third parties in non-current assets in the balance sheet.
These assets are initially recorded at fair value, being the consideration given, plus transaction costs. Recognition of the asset, or sale thereof, occurs on the date of trading which is the date on which Polyphor commits to purchase or sell the asset. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or been transferred and Polyphor has transferred substantially all risks and rewards of ownership.
Loans and receivables are carried at amortized cost using the effective interest method.

2.9 Trade accounts receivable and other accounts receivable

After initial recognition trade receivables are subsequently measured at amortized cost less provision for doubtful debts. A provision is established when there is evidence that the company will not be able to collect all amounts due according to the original terms of the receivables.

Trade accounts receivable and other accounts receivable consist of trade and miscellaneous other receivables. They generally have between 30 and 90 days terms. Unrecoverable trade receivables are written off when identified.

2.10 Property, plant and equipment

Property, plant and equipment are measured at historical cost less accumulated depreciation and impairment losses. The cost includes acquisition costs and any directly attributable costs of bringing the asset to its working condition and location for its intended use. If significant parts of an item of property, plant and equipment have different useful lives, then they are accounted for as separate items (major components) of property, plant and equipment.
When assets are sold or disposed of, any gain or loss resulting from their disposal is included in the income statement.
Depreciation is calculated to write off the cost of items of property, plant and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss.
The assets' useful life and residual values are reviewed and adjusted if appropriate at each balance sheet date.

The estimated useful lives are summarized as follows:

Office furniture	5 years
Laboratory equipment	8 years
IT equipment, office machines	3 years
Laboratory & building infrastructure "leasehold improvements"	10–15 years

2.11 Leases

Lease agreements under which Polyphor assumes essentially all the risks and rewards of ownership of an asset are classified as finance leases. Finance leases are capitalized at the commencement of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. The assets acquired under these contracts are depreciated over the shorter of the estimated useful life of the asset or the lease term.
Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases, and payments made are charged to the income statement on a straight-line basis over the period of the lease.

2.12 Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost where it is probable that the future economic benefits that are attributable to the asset will flow to the Company, and the cost of the asset can be reliably measured. Intangible assets with finite lives are measured at cost less accumulated amortization and any accumulated impairment losses. Amortisation is calculated to write off the cost of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss. The amortisation period and amortisation method are reviewed annually.
At the end of 2017, 2016 and 2015, the intangible assets held were primarily comprised of software and licence fees for software. Intangible assets are amortized using the straight-line method over three years.
Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

The Group has not capitalized any intangible assets with indefinite lives.

2.13 Technology Platforms

Technology Platforms relate to capitalized cost of PEMfinder® and MacroFinder® screening libraries which include directly attributable material and production cost.

PEMfinder® and MacroFinder® screening libraries are capitalized based on the number of compounds. In addition, specific characteristics of the compounds such as quantity and purity thresholds have to be met in order to qualify for asset recognition.

Future economic benefits from Technology Platforms are expected from selling these to industry partners engaged in drug discovery.

The cost of the build-up of the PEMfinder® and MacroFinder® screening libraries is fully written down to the extent that it is not recoverable.

Following the initial recognition the Technology Platforms assets are depreciated on a straight-line basis over the estimated remaining useful life based on the use of the compounds by screening activities as well as dilution of purity over time. The estimated useful life is as follows:

Technology Platforms	10 years

2.14 Impairment of property, plant and equipment, intangible assets and Technology Platforms

An impairment assessment is carried out when there is evidence that an asset may be impaired. If any such indication exists, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs of disposal and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or asset groups.

Where the carrying amount of an asset exceeds its recoverable amount, the asset is impaired to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An appropriate valuation model is used to determine fair value less costs of disposal. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded entities or other available fair value indicators.

Impairment losses are recognized in the income statement. When an impairment loss arises, the useful life of the asset in question is reviewed and, if necessary, the future depreciation / amortization charge is accelerated.

2.15 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2.16 Compound financial instruments – Convertible loan

Compound financial instruments issued by the Group comprise a loan that is convertible into share capital at the option of the holder whereby the number of shares to be issued varies depending on the share price during an equity or liquidation event.

As the conversion option of the lenders does not meet the fixed-for-fixed criteria, no equity component was identified. The entire financial liability was initially measured at the amount of cash received. The embedded derivative is subsequently measured at fair value through profit or loss, the host contract liability is measured at amortized cost.

Interest related to the financial liability is recognised in profit or loss. On potential conversion at maturity, the financial liability is reclassified to equity.

2.17 Share capital

The costs of an equity transaction are accounted for as a deduction from equity. Income tax relating to transaction costs of an equity transaction is accounted for in accordance with IAS 12. Equity transaction costs are comprised of only those incremental external costs directly attributable to the equity transaction which would otherwise have been avoided.

2.18 Revenue recognition

Revenue is recognised when the significant risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably and the amount of revenue can be measured reliably. Revenue is measured net of returns, trade discounts and volume rebates.

Deferred revenue

In the case of certain upfront and milestone payments, the payment received may not be fully recognized as certain terms of the agreement may require fulfilment of obligations after the period of the financial statements. In this case that part of the payment which relates to these obligations is recognized as deferred revenue. Release in future periods is only recorded according to the extent that the obligations are fulfilled.

R&D contributions

Collaboration agreements incorporate research services rendered by Polyphor to third parties. Polyphor recognizes revenues over the time the research contributions have been performed. Third party expenses which can be passed on are shown on a gross basis.

Upfront and milestone payments

Upfront payments and milestone payments are typically received in the context of licensing and technology access agreements or for granting exclusivity rights. If such payments are received for services that have already been provided then they are immediately recognized as revenues. In case all or a part of the payment relates to a defined exclusivity period or to services that have to be provided in the future, then the revenue is recognized pro rata during the term of the exclusivity period (or over an appropriate period as per the agreement).

Polyphor Library sales

Revenue from the sale of Polyphor Library components is recognized in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, which is usually on delivery as defined in the contract, at a fixed and determinable price, and when collectability is reasonably assured.

2.19 Research and development

Research and development ("R&D") expenses are charged to the income statement when incurred. Polyphor considers that the regulatory and other uncertainties inherent in the development of its key new products preclude it from capitalizing development costs.

Costs of applying for patents for internally developed products, costs of defending existing patents and costs of challenging patents held by third parties where these are considered invalid, are considered part of development expense and expensed as incurred.

2.20 Employee benefit costs

Wages, salaries, social security contributions, paid annual leave, sick leave and other benefits are paid or accrued undiscounted in the year in which the associated services are rendered by employees of the Group. Legal or constructive obligations such as bonus or profit-sharing plans are recognized for the amount expected to be paid in the year in which the services are provided and are presented under other liabilities.

Termination benefits are expensed at the earlier of when the Group can no longer withdraw the offer of those benefits and when the Group recognises costs for a restructuring. Benefits are expected to be settled wholly within 12 months of the reporting date, therefore they are not discounted.

Pension plans

The Company operates two pension schemes in Switzerland; one for all employees and an additional one for members of the Executive Management. The assets are held in separate trustee-administered funds. Contributions to these funds are made by both the employees and the Company in accordance with Swiss legal requirements and the plan rules. Both plans qualify as defined benefit plans under IFRS and provide for an annuity or a lump sum payment on retirement. In addition, the plans cover disability and death in service.

The Group's net obligation in respect of defined benefit plans is calculated by estimating the amount of future benefits that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The defined benefit obligations are calculated annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Group, the recognised asset is limited to the present value of economic benefits available in the form of any future reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in Other Comprehensive Income. The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognised in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in profit or loss. The Group recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs.

Share-based compensation

The Group' share-based compensation plans qualify as equity-settled plans. The fair value of the employee services received in exchange for the grant of shares or share options is recognized as an expense over the relevant vesting period in line with the graded vesting patterns of the awards. For equity-settled plans, the fair value is determined at the grant date. At each reporting date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement and a corresponding adjustment to equity.

In the year the options are exercised the proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and paid-in capital.

2.21 Taxation

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date. Current tax assets and liabilities are offset only if certain criteria are met.

Deferred income taxes

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on business plans for the Company and the reversal of temporary differences. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date. The measurement of deferred tax reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are offset only if certain criteria are met.

3. Segment Information

In 2017 the Group went through an internal reorganization which resulted in the establishment of two strategic business units. The two strategic business units are considered to be a reportable operating segment each. These business units offer different products and services, and are managed separately because they require different technology and marketing strategies. The following summary describes the operations of each reportable segment.

Reportable Segment	Operations
Pharma	Research, development and prospective commercialization of drugs, in particular the lead candidates, the OMPTA platform, as well as sales of Polyphor Libraries
Collaboration Services	Collaboration Services to third parties engaged in drug discovery

The Chief Operating Decision Maker (CODM) is the Company's Executive Management. The CODM allocates resources to and assesses the performance of each operating segment using the information outlined below. The CODM reviews the internal management reports of each business unit at least quarterly.

Headquarter activities are not separately reported but included in the reportable segments. Intersegment sales represent revenue generated between the business units. Transfer prices between operating segments are set out at arm's-length basis, based on the same bottom up cost calculations used for the capitalisation of the Technology Platform. No segment assets and liabilities are reported to the CODM for allocating resources and assessing segment performance.

Information related to each reportable segment is set out below. Operating loss per segment is used to measure and monitor performance because the Executive Management believes that this information is the most relevant in evaluating the results of the respective business units.

2017	Pharma	Collaboration Services	Total Segments	Eliminations	Total Group
Research and development contributions	263’039	4’034’891	4’297’931		4’297’931
Polyphor Library sales	1’040	0	1’040		1’040
Upfront and milestone payments	0	0	0		0
Intra-group revenue	0	2’080’800	2’080’800	-2’080’800	0
Total revenue	**264’079**	**6’115’691**	**6’379’770**	**-2’080’800**	**4’298’970**
Capitalized costs of Technology Plattforms	1’992’600	0	1’992’600		1’992’600
Other income	100’000	0	100’000		100’000
Cost of materials	-2’080’800	-1’358’584	-3’439’384	2’080’800	-1’358’584
Cost of third party services	-12’526’202	-298’940	-12’825’142		-12’825’142
Employee expenses	-9’585’351	-6’842’826	-16’428’177		-16’428’177
Rental expenses	-498’359	-703’042	-1’201’401		-1’201’401
Patent and trademark expenses	-1’306’619	0	-1’306’619		-1’306’619
Other operating expenses	-1’951’842	-3’089’859	-5’041’702		-5’041’702
Depreciation and amortization	-2’560’156	-623’219	-3’183’375		-3’183’375
Net operating expenses before one off expenses	**-28’416’730**	**-12’916’471**	**-41’333’201**	**2’080’800**	**-39’252’401**
Restructuring provision	0	-1’130’159	-1’130’159		-1’130’159
Curtailment	334’075	2’748’809	3’082’884		3’082’884
Impairment charges	-5’647’545	0	-5’647’545		-5’647’545
Net operating expenses	**-33’730’200**	**-11’297’821**	**-45’028’021**	**2’080’800**	**-42’947’221**
Operating loss	**-33’466’121**	**-5’182’129**	**-38’648’250**	**0**	**-38’648’250**
Financial income					30’733
Financial expenses					-446’425
Net foreign exchange loss					-31’514
Net loss for the period					**-39’095’457**

2016	Pharma	Collaboration Services	Total Segments	Eliminations	Total Group
Research and development contributions	1’876’410	4’195’304	6’071’714		6’071’714
Polyphor Library sales	367’804	0	367’804		367’804
Upfront and milestone payments	1’211’250	1’000’000	2’211’250		2’211’250
Intra-group revenue	0	4’534’200	4’534’200	-4’534’200	0
Total revenue	**3’455’464**	**9’729’504**	**13’184’968**	**-4’534’200**	**8’650’768**
Capitalized costs of Technology Plattforms	3’474’900	0	3’474’900		3’474’900
Cost of materials	-4’534’200	-1’783’578	-6’317’778	4’534’200	-1’783’578
Cost of third party services	-9’915’639	0	-9’915’639		-9’915’639
Employee expenses	-9’131’543	-6’992’101	-16’123’644		-16’123’644
Rental expenses	-470’599	-663’880	-1’134’479		-1’134’479
Patent and trademark expenses	-1’111’846	0	-1’111’846		-1’111’846
Other operating expenses	-1’146’515	-2’015’218	-3’161’733		-3’161’733
Depreciation and amortization	-2’150’786	-658’255	-2’809’042		-2’809’042
Net operating expenses	**-24’986’228**	**-12’113’033**	**-37’099’261**	**4’534’200**	**-32’565’061**
Operating loss	**-21’530’764**	**-2’383’529**	**-23’914’293**	**0**	**-23’914’293**
Financial income					27’381
Financial expenses					-226’002
Net foreign exchange loss					-24’724
Net loss for the period					**-24’137’639**

2015	Pharma	Collaboration Services	Total Segments	Eliminations	Total Group
Research and development contributions	0	4'326'801	4'326'801		4'326'801
Polyphor Library sales	387'787	0	387'787		387'787
Upfront and milestone payments	2'958'000	0	2'958'000		2'958'000
Intra-group revenue	0	1'289'250	1'289'250	-1'289'250	0
Total revenue	**3'345'787**	**5'616'051**	**8'961'838**	**-1'289'250**	**7'672'588**
Capitalized costs of Technology Plattforms	2'238'650	0	2'238'650		2'238'650
Change in inventory and work in progress	-79'025	0	-79'025		-79'025
Cost of materials	-1'289'250	-2'119'467	-3'408'717	1'289'250	-2'119'467
Cost of third party services	-18'444'664	-282'156	-18'726'820		-18'726'820
Employee expenses	-8'586'930	-7'908'967	-16'495'897		-16'495'897
Rental expenses	-484'697	-683'769	-1'168'465		-1'168'465
Patent and trademark expenses	-1'232'829	0	-1'232'829		-1'232'829
Other operating expenses	-903'182	-1'699'833	-2'603'015		-2'603'015
Depreciation and amortization	-2'025'672	-675'234	-2'700'906		-2'700'906
Net operating expenses	**-30'807'600**	**-13'369'424**	**-44'177'024**	**1'289'250**	**-42'887'774**
Operating loss	**-27'461'813**	**-7'753'373**	**-35'215'186**	**0**	**-35'215'186**
Financial income					44'366
Financial expenses					-255'560
Net foreign exchange loss					346'472
Net loss for the period					**-35'079'908**

Geographical information

Geographic revenue information is based on the location of the customers

Revenue by location	2017 CHF	2016 CHF	2015 CHF
Switzerland	2'360'831	3'438'187	2'608'354
Rest of Europe	65'577	373'904	2'393'618
United States	1'872'562	3'407'628	0
Asia	0	1'431'049	2'670'616
Total	**4'298'970**	**8'650'768**	**7'672'588**

Major customers

Information on major customer is as follows:

Revenue by major customers	2017 CHF	2016 CHF	2015 CHF
Customer "A", Switzerland	2'360'831	3'436'726	1'608'408
Customer "B", United States	203'780	1'876'410	0
Customer "C", Germany	59'259	0	2'102'461
Customer "D", Switzerland	0	0	999'946
Customer "E", Japan	0	1'209'867	1'955'606
Customer "F", United States	1'668'782	1'531'218	0
Other customers	6'318	596'547	1'006'167
Total	**4'298'970**	**8'650'768**	**7'672'588**

4. Cash and cash equivalents

Cash is held mainly in CHF, EUR, USD and GBP in the form of cash and bank deposits with Zürcher Kantonalbank and Credit Suisse.

Cash and cash equivalents comprise the following at December 31:

Cash and cash equivalents	2017 CHF	2016 CHF	2015 CHF
Cash at banks and on hand			
In CHF	20'254'175	11'891'537	33'452'772
In EUR	1'331'680	152'537	784'029
In USD	1'191'450	2'445'452	2'506'512
in GBP	1'782'327	105'569	1'053'732
Total at December 31	**24'559'631**	**14'595'095**	**37'797'045**

Cash at banks earns interest at floating rates based on monthly bank deposits rates. Funds not immediately needed are invested as current bank deposits with maturities up to three months, earning interest at the prevailing money market rates.

5. Trade accounts receivable, other accounts receivable and rent deposit

Trade accounts receivable are held primarily with large and mid-sized pharmaceutical companies. Payment terms of these receivables are typically 30–90 days and they bear no interest. Neither in the period under review nor in the previous periods, any overdue items have been identified.

	2017 CHF	2016 CHF	2015 CHF
Trade accounts receivable	620’457	304’453	843’125
Other accounts receivable	1’358’862	1’245’797	1’050’780
Rent deposit	447’221	447’159	447’022
Total at December 31	**2’426’540**	**1’997’409**	**2’340’927**

The other receivables consist largely of amounts due from the government (VAT reimbursable) and from social security institutions. They are due within 30–180 days and bear no interest.
No bad debt provision was recognized on these receivables as management estimates that no allowance is necessary as of December 31, 2017, 2016 and 2015. Rent deposit held with Zürcher Kantonalbank serves as collateral for the lease related to the facilities at the i-parc. The rent deposit earns interest at floating rates.

6. Prepaid expenses

As of December 31, 2017, 2016 and 2015 prepaid expenses relate primarily to prepaid patent and trademark expenses, service contracts, insurances and software licences.

7. Property, plant and equipment

The table below illustrates the property, plant and equipment held by the Group:

Property, plant and equipment (CHF)	Leasehold Improvements	Office Equipment	Laboratory Equipment	IT Equipment	Others	Total
Cost at January 1, 2015	7’601’736	248’456	8’909’947	1’188’197	151’160	18’099’496
Additions	–	–	754’559	64’443	–	819’002
Disposals	–	–	-718’507	-66’945	–	–785’452
Cost at December 31, 2015	**7’601’736**	**248’456**	**8’945’999**	**1’185’695**	**151’160**	**18’133’046**
Depreciation at January 1, 2015	3’451’682	238’175	6’822’344	1’065’640	84’251	11’662’092
Additions	508’170	3’906	494’903	79’655	14’913	1’101’547
Disposals	–	–	-718’507	-66’945	–	-785’452
Depreciation at December 31, 2015	**3’959’852**	**242’081**	**6’598’740**	**1’078’350**	**99’164**	**11’978’187**
Net book value at December 31, 2015	**3’641’884**	**6’375**	**2’347’259**	**107’345**	**51’996**	**6’154’859**

Property, plant and equipment (CHF)	Leasehold Improvements	Office Equipment	Laboratory Equipment	IT Equipment	Others	Total
Cost at January 1, 2016	7’601’736	248’456	8’945’999	1’185’695	151’160	18’133’046
Additions	–	7’480	92’381	66’114	–	165’975
Disposals	–	–	–	–	–	–
Cost at December 31, 2016	**7’601’736**	**255’936**	**9’038’380**	**1’251’809**	**151’160**	**18’299’021**
Depreciation at January 1, 2016	3’959’852	242’081	6’598’740	1’078’350	99’164	11’978’187
Additions	508’170	4’238	475’963	75’322	14’914	1’078’606
Disposals	–	–	–	–	–	–
Depreciation at December 31, 2016	**4’468’022**	**246’319**	**7’074’703**	**1’153’672**	**114’078**	**13’056’793**
Net book value at December 31, 2016	**3’133’714**	**9’617**	**1’963’677**	**98’137**	**37’082**	**5’242’228**
Cost at January 1, 2017	7’601’736	255’936	9’038’380	1’251’809	151’160	18’299’022
Additions	–	–	57’396	73’855	–	131’250
Disposals	–	–	-19’968	-3’708	–	-23’676
Cost at December 31, 2017	**7’601’736**	**255’936**	**9’075’808**	**1’321’955**	**151’160**	**18’406’595**
Depreciation at January 1, 2017	4’468’022	246’319	7’074’703	1’153’672	114’078	13’056’793
Additions	508’170	3’606	414’941	72’169	14’914	1’013’800
Disposals	–	–	-19’968	-3’706	–	-23’674
Depreciation at December 31, 2017	**4’976’192**	**249’925**	**7’469’676**	**1’222’134**	**128’992**	**14’046’919**
Net book value at December 31, 2017	**2’625’544**	**6’011**	**1’606’132**	**99’821**	**22’168**	**4’359’677**

Depreciation has been charged to:	2017 CHF	2016 CHF	2015 CHF
Research and development	857’714	930’707	941’784
Marketing and sales	44’974	41’819	45’470
General and administrative	111’112	106’079	114’293
Total	**1’013’800**	**1’078’606**	**1’101’547**

The Group entered no leasing agreement which has been classified as finance leasing.

In 2017, the opening balances of accumulated cost as well as of accumulated depreciation for the years 2015 and 2016 have been adjusted by the same amount of CHF 844’817. Neither the consolidated statements of financial positions nor the consolidated income statements are impacted by this adjustment.

8. Intangible assets

The table below illustrates the intangible assets held by the Group. At the end of 2017, 2016 and 2015 the intangible assets were primarily comprised of licence fee for IT-software:

	2017	2016	2015
Intangible assets	**CHF**	**CHF**	**CHF**
Cost at January 1	943'312	894'138	861'089
Additions	20'403	49'174	53'574
Disposals	–	–	-20'525
Cost at December 31	**963'715**	**943'312**	**894'138**
Amortisation at January 1	864'431	818'170	786'361
Additions	51'194	46'261	52'334
Disposals	–	–	-20'525
Amortisation at December 31	**915'625**	**864'431**	**818'170**
Net book value at December 31	**48'090**	**78'880**	**75'967**

	2017	2016	2015
Amortisation has been charged to:	**CHF**	**CHF**	**CHF**
Research and development	38'117	35'134	38'832
Marketing and sales	3'768	3'146	3'843
General and administrative	9'309	7'981	9'659
Total	**51'194**	**46'261**	**52'334**

In 2017, the opening balances of accumulated cost as well as of accumulated depreciation for the years 2015 and 2016 have been adjusted by the same amount of CHF 5'628. Neither the consolidated statements of financial positions nor the consolidated income statements are impacted by this adjustment.

9. Technology Platforms

Technology Platforms relate to capitalized expenses of PEMfinder® and MacroFinder® screening libraries. Polyphor has reached commercial proof of concept, as exemplified by the deal terms of the Novartis PEMfinder® and Boehringer Ingelheim MacroFinder® collaboration, thus confirming that future revenues can be generated due to these proprietary and patent protected drug discovery tools.

	2017	2016	2015
Technology Platforms	**CHF**	**CHF**	**CHF**
Cost at January 1	21'183'800	17'708'900	15'470'250
Additions	1'992'600	3'474'900	2'238'650
Cost at December 31	**23'176'400**	**21'183'800**	**17'708'900**
Depreciation at January 1	7'631'075	5'946'900	4'399'875
Additions	2'118'380	1'684'175	1'547'025
Impairment	5'647'545	–	–
Depreciation at December 31	**15'397'000**	**7'631'075**	**5'946'900**
Net book value at December 31	**7'779'400**	**13'552'725**	**11'762'000**

In 2017, 2016 and 2015 depreciation has been charged to research and development.

Impairment Testing "Technology Platforms"

During 2017 the Board of Directors decided to terminate the Collaboration Services Business which also uses Polyphor's Technology Platform for its business and hence the termination was identified to be an indicator for an impairment of the technology platform. The recoverable amount of the asset has been determined based on its value in use, by discounting the future cash flows to be generated from the sale of Technology Platforms to pharmaceutical companies. The recoverable amount of CHF 7'779'400 was lower than the carrying amount and an impairment loss of CHF 5'647'545 was recognised in the second half of 2017 (2016 and 2015: nil) and charged to research and development.

The recoverable amount has been determined using key assumptions that represent management's assessment of future cash flows in the relevant business and have been based on expectations for potential future sales of the Technology Platforms within the next ten years taking into account past experience and existing contracts. The cash flow projections included specific estimates for nine years as the general useful life of the Technology Platform is limited to ten years (see note 2.13).

The discount rate was a pre-tax measure based on the rate of 10-year government bonds issued by the Swiss government in the relevant market and in the same currency as the cash flows, adjusted for a risk premium to reflect both the increased risk of investing in equities generally and the systematic risk of the specific CGU.

in percent	**2017**
Discount rate	11.54%

10. Trade accounts payable and other liabilities

	2017	2016	2015
	CHF	**CHF**	**CHF**
Trade accounts payable	4'071'858	2'958'388	3'455'664
Other accounts payable	545'913	225'697	114'108
Prepayments	570'000	1'060'000	0
Deferred income / revenue	340'741	68'782	220'882
Total at December 31	**5'528'511**	**4'312'867**	**3'790'654**

Trade accounts payable are non-interest bearing and usually settled within 30 to 60 days. Other accounts payable comprises amounts due for pension fund, social security institutions, tax at source, issuance stamp duty and VAT.
Deferred revenue includes upfront payments received which may not be fully recognized as certain terms of the agreement may require fulfilment of obligations after the period of the financial statements.

11. Accrued expenses

The accrued expenses relate primarily to employee expenses, licence fees and other operating expenses. The employee expenses are considered to be non-financial liabilities. The licence fees and other operating expenses (financial) are included in financial liabilities (see note 21.5). Other operating expenses (financial) include accruals for energy costs, clinical costs, IT expenses and third party contractors / advisors.

	2017	2016	2015
	CHF	**CHF**	**CHF**
Employee expenses	1'713'312	1'457'221	1'257'563
Licence fees (financial)	96'000	92'624	26'533
Other operating expenses (financial)	2'337'615	1'133'863	1'461'025
Total at December 31	**4'146'927**	**2'683'708**	**2'745'121**

12. Restructuring

On November 27, 2017, as part of its strategic realignment and focus on the Pharma Business, the Group committed to a plan to discontinue their Collaboration Services Business. The plan includes 34 redundancies per November 30, 2017. The majority of the employees who have been made redundant have a notice period running until February 28, 2018. Approximately 7 employees will be employed until June-August in order to fulfil existing collaboration agreements. The restructuring does not affect Polyphor's research activities for its Pharma product pipeline. The restructuring also foresees that Polyphor will continue the sales of its Polyphor Libraries, however without offering employee-based collaboration support.
Following the announcement of the plan, the Group recognised a provision of CHF 1'130'159 for expected restructuring costs, including mainly employee termination benefits. The benefits are based on individual termination agreements agreed between management and the individual employees. Estimated restructuring costs are based on the terms of the relevant termination agreements. The restructuring is expected to be completed by August 2018.

13. Debt

Infrastructure loan
In 2008, Polyphor entered into a loan agreement to finance the laboratory and building infrastructure in its research building. The loan bears interest at a rate of 6% and is repayable in instalments over a period of 15 years. Based on this agreement, Polyphor obtained CHF 7'402'174 in 2008 and CHF 199'563 in 2009. As of December 31, 2017, 2016 and 2015, the loan is measured at amortized costs.
The time to maturity of the financial liabilities as of December 31, 2017 is between 1 and 62 months (see note 21.4).

Convertible loan
On February 3, 2017, a convertible loan of CHF 2'300'000 was made available to the Company. The pay-out of the convertible loan is split into several tranches, which are released after the achievement of predefined milestones. During the period under review, the company drew an amount of CHF 1'326'333.
Interest (3-month CHF LIBOR +2% p.a.) is accrued up to the earlier of (i) the date on which the loan is converted or repaid or (ii) the maturity date. The maturity date of the loan is February 3, 2024.

A conversion or repayment in cash within the first five years is only possible in two cases: listing of the Company's shares or default. The loan can be settled at the option of the lender through a variable number of equity shares based on the conversion price which is defined as a price per share at a discount of 20% to the share price at the subsequent listing.

14. Share capital

At December 31, 2017 the Company's share capital consists of Common Shares with a nominal value of CHF 2 each and Common B-shares with a nominal value of CHF 2 each. B-shareholders have the same voting rights as common shareholders but B-shareholders are not entitled to receive any proceeds out of the first CHF 8 million obtained in the case of liquidation or sale of the Company.

During the course of 2016 and 2015, the share capital did not change.

In March 2017, the general meeting of shareholders approved a share split with the ratio 1:50. The existing 114'242 shares (including Common B-shares) with a nominal value of CHF 100 per share were split into 5'712'100 new shares with a nominal value of CHF 2 per share. The shareholders also approved the adjustment of the conditional share capital in the amount of CHF 175'200 for the issuance of up to 87'600 fully paid in registered shares with a nominal value of CHF 2 per share (before share split: 1'752 fully paid in registered shares with a nominal value of CHF 100 per share).
During that general meeting the shareholders also approved the issue of 206'032 ordinary shares at an issue price of CHF 48 per share ("Tranche 1") and the increase of the conditional share capital from CHF 175'200 to new CHF 491'234 for the issuance of up to 245'617 fully paid in registered shares with a nominal value of CHF 2 per share. This conditional share capital is exclusively reserved for the members of the employee stock option plan.
With regard to the convertible loan (see note 13) the general meeting of shareholders also approved an additional conditional share capital in the amount of CHF 119'800 for the issuance of up to 59'900 fully paid in registered shares covering a potential exercise of the conversion right.
The shareholders additionally approved the creation of authorized capital with a maximum amount of CHF 1'249'998 and authorized the Board of Directors to issue a maximum of 624'999 registered shares with a nominal value of CHF 2 each at any time until March 31, 2018 ("Tranche 2").
The Board of Directors was also authorized to create an additional authorized capital to the maximum amount of CHF 333'332 by issuing a maximum of 166'666 registered shares with a nominal value of CHF 2 each at any time until September 31, 2018. This additional authorized capital is exclusively reserved for shareholders who fully participated in Tranche 1 and Tranche 2 of the capital increase which gives them the right until January 31, 2018 to purchase one additional share at a price of CHF 2 per share, for five shares already purchased in the two Tranches.

In July 2017 the Board of Directors decided to make use of the first authorized capital in the amount of CHF 1'234'770 by issuing 617'385 ordinary shares at an issue price of CHF 48 per share.
In December 2017 the Board of Directors also decided to make use of the second authorized capital in the amount of CHF 294'888 by issuing another 147'444 ordinary shares at an issue price of CHF 2 per share.
No dividends were declared or paid by the Company for the year under review (2015: nil, 2016: nil).

Shares (Number of shares	Common Shares	Common B-Shares	Total Shares	Nominal Value
Shares at January 1, 2015	5'410'200	301'900	5'712'100	11'424'200
Shares at December 31, 2015	**5'410'200**	**301'900**	**5'712'100**	**11'424'200**
Shares at January 1, 2016	5'410'200	301'900	5'712'100	11'424'200
Shares at December 31, 2016	**5'410'200**	**301'900**	**5'712'100**	**11'424'200**
Shares at January 1, 2017	5'410'200	301'900	5'712'100	11'424'200
Capital Increase	206'032	–	206'032	412'064
Capital Increase (authorized capital)	617'385	–	617'385	1'234'770
Capital Increase (authorized capital)	147'444	–	147'444	294'888
Shares at December 31, 2017	**6'381'061**	**301'900**	**6'682'961**	**13'365'922**

The number of shares disclosed for the years 2015 and 2016 are presented by taking the share split of 1:50 into account.

15. Share-based payment arrangements

In 2013, the Group established a share option program (employee stock option program) that entitles key management personnel and other senior employees to purchase shares in the Company. Under these programmes, holders of vested options are entitled to purchase shares at a price of CHF 5 (prior to share split CHF 250).

All existing stock options are protected against any share splits. Due to the share split in March 2017 the number of options increased accordingly and the respective exercise price has been adjusted. According to the protection clause, one old stock option with an exercise price of CHF 250 was split into fifty new stock options with an exercise price of CHF 5. All other conditions remained unchanged.
Based on this plan, the Company granted 17'400 stock options to employees during the period under review. The fair value of the stock options has been determined at the grant date based on the calculated share price of the Company's last capital increase using the Black-Scholes model. 25% of the stock options vest one year after vesting start date and the balance (75%) vest in twelve quarterly equal instalments of 6.25% per calendar quarter. The maximum term for exercising the options is 10 years.

The tables below shows the assumptions applied to value the share based payment arrangements for 2017, 2016 and 2015 (all information adjusted for the share-split in March 2017):

2017

Stock options, conditions and assumptions with a maximum vesting period of 4 years

Nature of arrangement	Grant of stock options
Grant date	various
Number of options granted	17'400
Exercise price (CHF)	5
Share price at date of grant (CHF)	40
Vesting period (years)	4
Expected volatility (%)	25
Expected option life at grant date (years)	7
Risk-free interest rate p.a. (%)	-0.06 to -0.21
Expected dividend	Zero
Estimated fair value of option at grant date (CHF)	35
Expiry date	April 30 to June 30, 2027

2016

Stock options, conditions and assumptions with a maximum vesting period of 4 and 3 years

Nature of arrangement	Grant of stock options
Grant date	various
Number of options granted	35'500, 25'000 (before share split 710, 500)
Exercise price (CHF)	5 (before share split 250)
Share price at date of grant (CHF)	5 (before share split 3'250)
Vesting period (years)	4, 3
Expected volatility (%)	25
Expected option life at grant date (years)	7
Risk-free interest rate p.a. (%)	-0.59
Expected dividend	Zero
Estimated fair value of option at grant date (CHF)	60
Expiry date	December 31, 2025 to October 31, 2026

In 2016 the Company granted 35'500 stock options, 25% of these vest one year after vesting start date and the balance (75%) vest in twelve quarterly equal instalments of 6.25% per calendar quarter.
In 2016 the Company granted 25'000 stock options to one employee, 33.33% of which vest one year after vesting start date and the balance (66.67%) vest in eight quarterly equal instalments of 8.33% per calendar quarter.

2015

Stock options, conditions and assumptions with a maximum vesting period of 4 and 3 years

Nature of arrangement	Grant of stock options
Grant date	various
Number of options granted	14'500 (before share split 290)
Exercise price (CHF)	5 (before share split 250)
Share price at date of grant (CHF)	5 (before share split 3'250)
Vesting period (years)	4
Expected volatility (%)	25
Expected option life at grant date (years)	7
Risk-free interest rate p.a. (%)	0.37
Expected dividend	Zero
Estimated fair value of option at grant date (CHF)	60
Expiry date	December 31, 2024 to June 30, 2025

In 2015 the Company granted 14'500 stock options, 25% of these vest one year after vesting start date and the balance (75%) vest in twelve quarterly equal instalments of 6.25% per calendar quarter.

The movements in the number of all stock options are as follows:

	after Share Split		before Share Split	
Stock option movements	Options (number)	Weighted average exercise price (CHF)	Options (number)	Weighted average exercise price (CHF)
Balance outstanding December 31, 2014	**29'650**	**5**	**593**	**250**
Granted	14'500	5	290	250
Forfeited	-1'550	5	-31	250
Balance outstanding December 31, 2015	**42'600**	**5**	**852**	**250**
Granted	60'500	5	1'210	250
Forfeited	-8'100	5	-162	250
Balance outstanding December 31, 2016	**95'000**	**5**	**1'900**	**250**
Granted	17'400	5	348	250
Expired	-8'950	5	-179	250
Forfeited	-10'950	5	-219	250
Balance outstanding December 31, 2017	**92'500**	**5**	**1'850**	**250**

The following table applies to all stock options outstanding at December 31, 2017:

Exercise price (after Share Split) (CHF)	Options (number)	Weighted average remaining contractual life (years)	Exercisable options (number)
5	5'950	5.9	5'950
5	15'650	6.0	15'650
5	1'400	6.5	1'200
5	700	7.0	550
5	550	7.5	350
5	7'300	8.0	3'300
5	19'250	8.5	9'450
5	25'000	8.8	9'700
5	7'500	9.3	0
5	5'000	9.4	0
5	4'200	9.5	0
Total	**92'500**	**8.1**	**46'150**

The following table applies to all stock options outstanding at December 31, 2016:

Exercise price (CHF)	Exercise price (CHF)	Options (number)	Options (number)	Weighted average remaining contractual life (years)	Exercisable options (number)	Exercisable options (number)
5	250*	8'650	173*	6.9	8'650	173*
5	250*	18'700	374*	7.0	15'300	306*
5	250*	1'400	28*	7.5	900	18*
5	250*	2'400	48*	8.0	1'350	27*
5	250*	5'850	117*	8.5	4'300	86*
5	250*	9'400	188*	9.0	2'350	47*
5	250*	23'600	472*	9.5	6'250	125*
5	250*	25'000	500*	9.8	1'400	28*
Total		**95'000**	**1'900***	**8.7**	**40'500**	**810***

The following table applies to all stock options outstanding at December 31, 2015:

Exercise price (CHF)	Exercise price (CHF)	Options (number)	Options (number)	Weighted average remaining contractual life (years)	Exercisable options (number)	Exercisable options (number)
5	250*	8'650	173*	7.9	7'150	143*
5	250*	18'700	374*	8.0	9'350	187*
5	250*	1'400	28*	8.5	550	11*
5	250*	2'400	48*	9.0	800	16*
5	250*	11'450	229*	9.5	1'450	29*
Total		**42'600**	**852***	**8.7**	**19'300**	**386***

* before share split

The expenses for share-based compensation recognized in the income statement as follows:

	2017 CHF	2016 CHF	2015 CHF
Share-based compensation	**1'333'081**	**1'449'598**	**662'711**

16. Expenses by nature

The following tables include the company's operating expenses by their nature.

	2017 CHF	2016 CHF	2015 CHF
Capitalized costs of Technology Plattforms	1'992'600	3'474'900	2'238'650
Other income	100'000	0	0
Change in inventory and work in progress	0	0	-79'025
Cost of materials	-1'358'584	-1'783'578	-2'119'467
Cost of third party services	-12'825'142	-9'915'639	-18'726'820
Employee expenses	-14'475'453	-16'123'644	-16'495'897
Rental expenses	-1'201'401	-1'134'479	-1'168'465
Patent and trademark expenses	-1'306'619	-1'111'846	-1'232'829
Other operating expenses	-5'041'701	-3'161'733	-2'603'015
Depreciation and amortization	-8'830'920	-2'809'042	-2'700'906
Total net operating expenses	**-42'947'221**	**-32'565'061**	**-42'887'774**

Employee expenses	2017 CHF	2016 CHF	2015 CHF
Salaries	-14'720'862	-13'120'561	-14'231'319
Pension expenses, defined benefit plans	1'578'490	-1'553'485	-1'601'867
Share-based compensation	-1'333'081	-1'449'598	-662'711
Total employee expenses	**-14'475'453**	**-16'123'644**	**-16'495'897**

Employee expenses have been charged to:	2017 CHF	2016 CHF	2015 CHF
Research and development	-10'777'826	-12'245'421	-12'239'940
Marketing and sales	-1'065'418	-1'096'594	-1'211'297
General and administrative	-2'632'208	-2'781'630	-3'044'660
Total	**-14'475'453**	**-16'123'644**	**-16'495'897**

17. Employee benefits

In accordance with the Swiss pension fund law "Federal Act on Occupational Old Age, Survivors' and Invalidity Pension Provision" (OPA), Polyphor AG is affiliated with a collective independent pension fund. The fund provides for retirement benefits, as well as risk benefits (death and disability). The company entered into an agreement with "Vita Sammelstiftungen" for occupational benefits. The "Vita Sammelstiftungen" is responsible for the governance of the plan; its Board is composed of an equal number of representatives from the employers and employees chosen from all affiliated companies. "Vita Sammelstiftungen" has set up investment guidelines, defining in particular the strategic allocation with margins. The "Vita Sammelstiftungen" has reinsured its risks (investment risk, mortality and disability risks) with Zurich Life Insurance Company Ltd. Zurich Investment Foundation manages the savings capital / investments on behalf of "Vita Sammelstiftungen". The accumulated saving capital is allocated to each insured individual and consists of annual contributions, saving credits and interest credits. In certain situations, additional payments or increased periodic contributions by the employer may become due based on the pension plans' funded status as measured under Swiss pension rules (OPA). The assets cannot revert to the employer. Contributions to the plans are shared equally between the employer and the employees. Contributions are computed as percentage of the salary, depending on age.

In addition, the company entered into an agreement with "Vita Plus Sammelstiftungen" for members of the Company's Executive Management. The fund provides for retirement benefits and risk benefits (death and disability) supplementary to the minimum occupational provisions according to the law OPA. The Board of the "Vita Plus Sammelstiftungen" is responsible for the governance of the plan. The "Vita Plus Sammelstiftungen" has reinsured its risks (investment risk, mortality and disability risks) with Zurich Life Insurance Company Ltd ("Zurich"). Contributions to the plans are solely paid by the employer.

The defined benefit obligations are estimated on a yearly basis. Plan assets are recognised at fair values. An independent actuary has calculated the net pension liability.

As a result of the restructuring described in note 12, the Group recognised a curtailment gain of CHF 3'082'884 in the profit and loss.

Detailed information on the defined benefit plans:

Changes in the present value of the defined benefit obligation (DBO)	**2017 CHF**	**2016 CHF**	**2015 CHF**
Present value of DBO at the beginning of the year	27'105'601	26'639'944	24'189'776
Current service cost	1'367'874	1'406'226	1'324'994
Contributions by the employees	739'847	697'802	750'000
Curtailment	-3'082'884	0	0
Interest cost	179'179	237'204	275'407
Past service cost	0	0	203'574
Benefits (paid) / deposited	-1'476'248	-2'199'223	-575'331
Actuarial (gains) / losses:			
From changes in demographic assumptions	0	1'040'731	0
From changes in financial assumptions	509'621	561'092	-599'072
From experience adjustments	826'411	-1'278'175	1'070'596
Present value of DBO at the end of the year	**26'169'401**	**27'105'601**	**26'639'944**

Changes in the fair value of the plan assets	**2017 CHF**	**2016 CHF**	**2015 CHF**
Fair value of the plan assets at the beginning of the year	18'252'412	18'423'585	16'731'446
Interest Income	121'632	170'897	202'108
Contributions by the employer	1'027'994	928'117	973'655
Contributions by the employees	739'847	697'802	750'000
Benefits (paid) / deposited	-1'476'248	-2'199'223	-575'331
Administration cost of insurance company	-78'973	-80'952	0
Remeasurement of plan assets	293'082	312'186	341'707
Fair value of the plan assets at the end of the year	**18'879'746**	**18'252'412**	**18'423'585**

Debt of the company resulting from pension liabilities	**2017 CHF**	**2016 CHF**	**2015 CHF**
Present value of the defined benefit obligation	26'169'401	27'105'601	26'639'944
Fair value of the plan assets	-18'879'746	-18'252'412	-18'423'585
Funded status	**7'289'655**	**8'853'189**	**8'216'359**
Net defined benefit liabilities	**7'289'655**	**8'853'189**	**8'216'359**

Pension expense recognized in profit and loss	**2017 CHF**	**2016 CHF**	**2015 CHF**
Current service cost	1'367'874	1'406'226	1'324'994
Curtailment	-3'082'884	0	0
Past service cost	0	0	203'574
Administration cost of insurance company	78'973	80'952	0
Net-interest cost	57'547	66'307	73'299
Pension expense recognized in profit and loss	**-1'578'490**	**1'553'485**	**1'601'867**

Pension expense recognized in other comprehensive income (OCI)	**2017 CHF**	**2016 CHF**	**2015 CHF**
Actuarial losses / (gains) of the current year	1'336'032	323'648	471'524
Remeasurement of plan assets	-293'082	-312'186	-341'707
Pension expense recognized in OCI	**1'042'950**	**11'462**	**129'817**

Reconciliation of net defined benefit liabilities	**2017 CHF**	**2016 CHF**	**2015 CHF**
Net defined benefit liabilities at the beginning of the year	8'853'189	8'216'359	7'458'330
Expense recognized in profit and loss	-1'578'490	1'553'485	1'601'867
Expense recognized in OCI	1'042'950	11'462	129'817
Contributions by the employer	-1'027'994	-928'117	-973'655
Net defined benefit liabilities at the end of the year	**7'289'655**	**8'853'189**	**8'216'359**

Asset allocation	2017 CHF	2016 CHF	2015 CHF
Cash	132’158	182’524	497’437
Debt instruments	5’607’285	5’658’248	6’319’290
Equity instruments	4’191’304	4’052’035	4’200’577
Property	1’642’538	1’679’222	1’823’935
Mortgages	1’057’266	1’022’135	1’105’415
Assets from insurance contracts	3’134’038	2’500’580	1’860’782
Others	3’115’158	3’157’667	2’616’149
Total	**18’879’746**	**18’252’412**	**18’423’585**

Principal actuarial assumptions at the end of the year	2017	2016	2015
Discount rate	0.70%	0.65%	0.90%
Expected rate of salary increase	1.00%	1.00%	0.50%
Expected rate of pension increase	0.00%	0.00%	0.00%

Sensitivity analysis, change in DBO	2017 CHF	2016 CHF	2015 CHF
if the discount rate is changed by +0.5%	-2'304'243	-1'544'800	2'022'476
if the discount rate is changed by -0.5%	2'660'382	1'644'524	-2'355'593
if the expected rate of salary increase is changed by +0.5	348'219	362'573	-405'299
if the expected rate of salary increase is changed by -0.5%	-332'041	-353'790	417'656
if the expected rate of pension increase is changed by +0.5%	1'384'234	1'142'597	-1'195'256
if the expected rate of pension increase is changed by -0.5% (not less then 0%)	n/a	n/a	1'079'520

The weighted average duration of the defined benefit obligation is 17.5 years (2016: 18.6 years; 2015: 16.5 years).
In 2018, the Company expects to contribute at least CHF 910’858 to its defined benefit pension plans.
The investment strategy of Vita Joint Foundation (“Vita Sammelstiftungen”) is determined by the Foundation Board within the limits of BVG investment regulations. Pension assets are invested in secure long-term investments, in collective investment schemes managed by Zurich Investment Foundation, Aberdeen Global Services S.A., Adveq Management SA, CapVis Equity Partners SA and Rye Harbour CLO Ltd. The disclosed investment allocation as of July 1, 2017 consisted of cash and cash equivalents (1%), Swiss bonds (8.5%), foreign bonds (26%), Swiss equities (6%), foreign equities (17.5%), real estate (10%), alternative investments (23%) and mortgages (8%). No investments in shares of Polyphor AG have been disclosed.
At the Vita Plus Sammelstiftung, the entire pension assets are held by Zurich. The pension assets are fully protected (capital guarantee) by Zurich, which also guarantees interest payments on pension assets at an annually defined interest rate (interest guarantee). Vita Plus does not invest in direct investments, but rather “transfers” the capital to Zurich. It is supervised by FINMA and must ensure at least the statutory requirements at all times.

Notes to the Consolidated Financial Statements as of December 31, 2017

18. Income taxes and deferred taxes

As the Group companies are still in loss making situations, no current income taxes have been charged to the Group. The Group has the following unrecognized tax loss carry-forwards available:

Tax loss carry-forwards	2017 CHF	2016 CHF	2015 CHF
for one year	17’665’822	10’248’486	14’473’323
for two years	16’712’779	17’665’822	10’248’486
for three years	0	16’712’779	17’665’822
for four years	20’701’071	0	16’712’779
for five years	34’651’850	20’701’071	0
for six years	21’193’708	34’651’850	20’701’071
for seven years	40’354’933	21’193’708	34’651’850
Total	**151’280’163**	**121’173’716**	**114’453’331**

The significant components of deferred taxes are shown in the following table:

Deferred taxes	2017 CHF	2016 CHF	2015 CHF
Deductible temporary differences:			
Pension liability	7’289’655	8’853’189	8’216’359
Net deductible / (taxable) temporary differences	7’289’655	8’853’189	8’216’359
Deferred tax asset / (liability) from temporary differences	1’508’959	1’832’610	1’700’786
Offset by deferred tax of tax loss carry-forwards	0	0	0

Deferred tax assets not recognized mainly consist of tax losses in Switzerland which can be carried forward for 7 years.
The Group’s expected tax rate is 20.7% for the period under review (2016: 20.7%; 2015: 20.7%), which is the expected statutory tax rate of Polyphor Ltd.

The following table shows the reconciliation between expected and effective taxes: Expenses not deductible for tax purposes mainly related to share-based payment expense recognized in the respective period.

Income tax reconciliation	2017 CHF	2016 CHF	2015 CHF
Net income / (loss) before taxes	-39'095'457	-24'137'639	-35'079'908
Tax expense / (income) at applicable tax rate (20.7%; prior years 20.7%)	-8'092'760	-4'996'491	-7'261'541
Tax effect of non-deductible expenses	275'948	300'067	137'181
Effect of unrecognised deferred taxes on tax loss carry-forwards	8'356'354	4'387'473	7'173'175
Effect of unrecognised deferred taxes on temporary differences	-539'542	308'951	-48'815
Used tax loss carry-forwards, not recognized as deferred tax assets	0	0	0
Effective tax income / (expenses)	**0**	**0**	**0**
Effective tax rate	**0%**	**0%**	**0%**

19. Commitments

Operating Lease Commitments:

The company leases its two facilities at the i-parc in Allschwil. The duration of these contracts is until January 1, 2020 and 15 years (until 2022) with the option to extend the leases at the end of these periods.

Operating leases	2017 CHF	2016 CHF	2015 CHF
Due within 1 year	1'075'180	1'208'550	1'141'625
Due within 2 to 5 years	3'559'706	3'613'856	3'918'942
Due after 5 years	0	1'054'041	1'957'506
Total at December 31	**4'634'886**	**5'876'447**	**7'018'073**

20. Earnings per share (EPS)

Basic and diluted earnings per share have been computed based upon the weighted average number of registered shares outstanding. Basic earnings per share excludes any dilutive effects of options, warrants and convertible loans. Outstanding employee stock options to purchase registered shares were not included in the computation of the dilutive earnings per share as the effect would have been anti-dilutive. The convertible loan is also anti-dilutive and is ignored in the calculation of diluted earnings per share in 2017.
In March 2017, the General Meeting of Polyphor voted in favor of a stock split at the ratio of 1 to 50. Accordingly, the earnings per share for 2016 and 2015 were adjusted retrospectively.

Basic and diluted earnings	2017 CHF	2016 CHF	2015 CHF
Net loss attributable to the ordinary shareholders	-39'095'457	-24'137'639	-35'079'908
Net loss attributable to the ordinary shareholders	**-39'095'457**	**-24'137'639**	**-35'079'908**

Weighted average number of shares (after share split)	2017 CHF	2016 CHF	2015 CHF
Weighted average number of ordinary shares (basic)	6'186'861	5'712'100	5'712'100
Weighted average number of ordinary shares (diluted)	6'186'861	5'712'100	5'712'100

Earnings per share	2017 CHF	2016 CHF	2015 CHF
Basic earnigs per share (after split)	-6.32	-4.23	-6.14
Dilluted earnings per share (after split)	-6.32	-4.23	-6.14

21. Financial Risk Management Objectives and Policies

While Polyphor works with clinical research organizations ("CRO") in Europe, Asia and the United States of America, Polyphor conducts its own R&D activities exclusively in Switzerland. The Group is exposed to a variety of financial risks, such as foreign exchange rate risk, credit risk, liquidity risk, and interest rate risk. Polyphor's overall financial risk management program focuses on securing capital protection (measured in CHF) to ensure that the funds provided by its investors will be available for the primary purpose.
As a consequence, it is Polyphor's policy to strictly avoid significant exposures in foreign currencies and not to invest in financial instruments that do not guarantee capital protection. Furthermore, Polyphor only concludes contracts with selected financial institutions of high credit quality and does not engage in speculative transactions.

21.1 Foreign exchange rate risk

Polyphor's primary exposure to financial risk is due to fluctuation of exchange rates between CHF, EUR, USD and GBP. Financial assets held in foreign currencies typically do not exceed cash needed in these currencies during the course of the next 12 months. Most of the trade receivables are paid in CHF.

The following table demonstrates the sensitivity on the net result pre-tax to a reasonable possible change in EUR, USD and GBP exchange rate, with all other variables held constant:

	2017 CHF	2016 CHF	2015 CHF
EUR positions			
+ 10%	297'056	-83'001	-106'043
- 10%	-297'056	83'001	106'043
USD positions			
+ 10%	163'669	210'513	219'475
- 10%	-163'669	-210'513	-219'475
GBP positions			
+ 10%	212'543	-12'112	96'254
- 10%	-212'543	12'112	-96'254

21.2 Interest rate risk

Polyphor earns interest income on cash and cash equivalents and its profit and loss may be influenced by changes in market interest rates. Polyphor deposits its cash in high quality Swiss banks in line with its treasury guidelines.

The following table demonstrates the minimal sensitivity on the net result to a reasonable possible change in interest rates, with all other variables held constant. There is no impact on Polyphor's equity.

	2017 CHF	2016 CHF	2015 CHF
CHF positions			
+ 50 basis points	95'971	61'693	169'499
- 50 basis points	-95'971	-61'693	-169'499
EUR positions			
+ 50 basis points	6'658	763	3'920
- 50 basis points	-6'658	-763	-3'920
USD positions			
+ 100 basis points	11'914	24'455	25'065
- 100 basis points	-11'914	-24'455	-25'065
GBP positions			
+ 100 basis points	17'810	1'059	10'537
- 100 basis points	-17'810	-1'059	-10'537

21.3 Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and investments in debt securities.

Polyphor holds its cash deposits almost exclusively with AAA-rated Zürcher Kantonalbank, the A1-rated Credit Suisse and the A+-rated UBS.

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the factors that may influence the credit risk of its customer base, including the default risk associated with the industry and country in which customers operate. Polyphor's customers comprise pharmaceutical and biotech companies which have been paying their invoices on time. Sales of products or partnerships are generally provided to customers or with partners with an appropriate credit history and a commitment to ethical business. The maximum credit risk exposure is limited to the carrying amount of its financial assets.

21.4 Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents. Currently Polyphor is financed primarily through equity. Polyphor's treasury calculates on a rolling basis the needs for settling the current expenses against the need for optimized financial investments.

Changes in liabilities arising from financing activities	**January 1, 2017**	**inflows**	**outflows**	**non-cash items**	**December 31, 2017**
Current interest-bearing loans and borrowings	545'025	–	-545'025	574'712	574'713
Non-current interest-bearing loans and borrowings	3'326'305	1'326'310	–	-394'540	4'258'074
Total liabilities from financing activities	**3'871'330**	**1'326'310**	**-545'025**	**180'172**	**4'832'787**

Duration of Financial liabilities		**contractual cash flows**			
(CHF)	**Carrying amount**	**1 to 3 months**	**4 to 12 months**	**2–5 years**	**more than 5 years**
Trade accounts payables	**4'071'858**	4'071'858	–	–	–
Accrued Expenses	**2'433'615**	2'433'615	–	–	–
Other loans	**3'326'305**	184'421	553'262	2'950'728	122'947
Convertible loan	**1'506'483**	–	–	1'464'379	–
Total as per December 31, 2017	**11'338'260**	**6'689'894**	**553'262**	**4'415'107**	**122'947**
Trade accounts payables	**2'958'388**	2'958'388	–	–	–
Accrued Expenses	**1'226'487**	1'226'487	–	–	–
Other loans	**3'871'330**	184'421	553'262	2'950'728	860'629
Convertible loan	**–**	–	–	–	–
Total as per December 31, 2016	**8'056'205**	**4'369'296**	**553'262**	**2'950'728**	**860'629**
Trade accounts payables	**3'455'664**	3'455'664	–	–	–
Accrued Expenses	**1'487'558**	1'487'558	–	–	–
Other loans	**4'388'203**	184'421	553'262	2'950'728	1'598'311
Convertible loan	**–**	–	–	–	–
Total as per December 31, 2015	**9'331'425**	**5'127'643**	**553'262**	**2'950'728**	**1'598'311**

21.5 Categories of financial instruments

The following table shows the carrying amounts and fair values of financial assets and financial liabilities.

Year ended December 31, 2017 (CHF)	Book value	Loans and receivables	Other liabilities at amortized costs
Assets			
Cash and cash equivalents	24'559'631	24'559'631	0
Trade accounts receivable	620'457	620'457	0
Rent deposit	447'221	447'221	0
Total	**25'627'309**	**25'627'309**	**0**
Liabilities			
Trade accounts payable	4'071'858	0	4'071'858
Debt (current and non-current)	4'832'787	0	4'832'787
Accrued expenses	2'433'615	0	2'433'615
Total	**11'338'260**	**0**	**11'338'260**

Year ended December 31, 2016 (CHF)	Book value	Loans and receivables	Other liabilities at amortized costs
Assets			
Cash and cash equivalents	14'595'095	14'595'095	0
Trade accounts receivable	304'453	304'453	0
Rent deposit	447'159	447'159	0
Total	**15'346'706**	**15'346'706**	**0**
Liabilities			
Trade accounts payable	2'958'388	0	2'958'388
Debt (current and non-current)	3'871'330	0	3'871'330
Accrued expenses	1'226'487	0	1'226'487
Total	**8'056'205**	**0**	**8'056'205**

Year ended December 31, 2015 (CHF)	Book value	Loans and receivables	Other liabilities at amortized costs
Assets			
Cash and cash equivalents	37'797'045	37'797'045	0
Trade accounts receivable	843'125	843'125	0
Rent deposit	447'022	447'022	0
Total	**39'087'192**	**39'087'192**	**0**
Liabilities			
Trade accounts payable	3'455'664	0	3'455'664
Debt (current and non-current)	4'388'203	0	4'388'203
Accrued expenses	1'487'558	0	1'487'558
Total	**9'331'425**	**0**	**9'331'425**

21.6 Capital Management

Polyphor's capital management aims at providing adequate cash funds to ensure the financing of successful research and development activities. The capital management is focused on the cash and cash equivalents position and is governed by conservative investment policy guidelines.
No changes have been made to the goals and policies of the treasury management during the past three reporting years.

22. Transactions with related parties

Key management
Key management includes the Executive Management and the Board of Directors.

Compensation to the Executive Management:

	2017 CHF	2016 CHF	2015 CHF
Short-term employee benefits	2'116'073	1'766'103	2'127'766
Post-employment benefits (pension fund)	443'363	319'159	315'940
Share-based compensation	1'301'379	561'516	213'544
Total	**3'860'815**	**2'646'778**	**2'657'250**

In 2017 two employees joined the Executive Management and two members left during the year. Therefore at the end of the reporting year the Executive Management comprised of 7 members (2016: 7 members, 2015: 7 members). In 2017, 2016 and 2015, no other long-term benefits and no termination benefits have been paid to the Executive Management.

Compensation to the Board of Directors:
In 2017 the Chairman of the Board of Directors has received a gross compensation of CHF 70'000 (2016: CHF 70'000, 2015: CHF 70'000), the Vice-Chairman of the Board of Directors has received a gross compensation of CHF 50'000 (2016: CHF 50'000, 2015: CHF 50'000) and all other Board Members have received a gross compensation of CHF 35'000 each (2016: CHF 35'000, 2015: CHF 35'000). In 2017, the share based compensation to a Board Member amounted to CHF 3'161 (2016: CHF 9'568; 2015: CHF 19'413).
In 2016, one member joined the Board of Directors, therefore at the end of the reporting year the Board of Directors included seven members, in 2015 the Board of Directors included six members.

Other related party transactions

Purchases of services	2017 CHF	2016 CHF	2015 CHF
Consulting services of related parties	283'994	132'122	50'034

Year-end balances arising from purchases of services at December 31,	2017 CHF	2016 CHF	2015 CHF
Payables to related parties	2'270	68'483	0
Accruals for related parties	0	35'000	0

Major Shareholders

As of December 31, 2017 the major shareholders are

	2017
Ingro Finanz AG	18.1%
Varuma AG	10.2%
BioMedinvest I Limited	4.4%
Rosetta Capital VGP Limited	3.8%
Jack Baldwin	3.5%
Daniel Obrecht	3.0%
Baumann&CIE	2.8%
Jean-Pierre Obrecht	2.2%

23. Material uncertainties and ability to continue operations

Polyphor's current funding is not sufficient to support the going concern assumption and the Company depends on further financing to ensure the continuation of its operations through the end of 2018 and to execute its strategy as outlined below.

The ability to continue business operations until final approval of murepavadin and / or balixafortide is contingent on the availability of sufficient financial resources. As a consequence, the Company has implemented restructuring measures to further reduce its workforce operational costs and its liabilities in connection with other obligations.

In addition, Management and the Board of Directors has initiated measures to secure additional financing by exploring possibilities of a capital increase, as well as sale or licensing of its assets. Polyphor has received expression of interest (nonbinding) from third parties. Whilst the Management and Board of Directors continue to apply best efforts to evaluate available options and take the steps described, there can be no guarantee that any transaction can be realized or that such transaction would generate sufficient funds to finance further operations.

The access to additional funds is decisive for Polyphor and its ability to continue operations and the absence of such a transaction would make it impossible for the Company to continue as a going concern. Under such circumstances, the Company would have to discontinue its business operations and could no longer apply the going concern assumption in preparing its financial statements for 2018.

The Board of Directors and Management of the Group have concluded that the combination of the above conditions and circumstances indicates the existence of a material uncertainty, which may potentially cast significant doubt about the Group's ability to continue as a going concern. Nevertheless, having assessed the situation, the Directors and Management believe that additional financing by exploring possibilities of a capital increase, as well as sale or licensing of its assets will be reached and the Group will be able to manage various business risks in uncertain and volatile environment and will be able to continue its operations for the foreseeable future in the normal course of business. For these reasons, they continue to adopt the going concern basis of accounting in preparing the Group's financial statements for the period ended December 31, 2017.

24. Events following the Balance Sheet date

In March 2017, the general meeting of shareholders authorized the Board of Directors to create authorized capital to the maximum amount of CHF 333'332 by issuing a maximum of 166'666 registered shares with a nominal value of CHF 2 each. This authorized capital is exclusively reserved for shareholders who fully participated in Tranche 1 and Tranche 2 of the 2017 capital increase which gives them the right until January 31, 2018 to purchase one additional share at a price of CHF 2 per share, for five shares already purchased in the two Tranches. In December 2017 the Board of Directors decided to make use of a part of the authorized capital in the amount of CHF 294'888 by issuing 147'444 ordinary shares at an issue price of CHF 2 per share. Until the end of the subscription period, a maximum of 17'155 shares can be subscribed for and be settled by Q2 2018. This would lead to a cash inflow of maximum CHF 34'310 for Polyphor and the issuance of 17'155 additional shares.

Dr. Jerry Karabelas
Chairman of the Board of Directors

Giacomo Di Nepi
CEO

Kalina Scott
CFO

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To the Board of Directors of

Polyphor Ltd, Allschwil

Basle, 12 February 2018

Independent auditor's report on the audit of the consolidated financial statements

Opinion
In accordance with the terms of our engagement, we have audited the consolidated financial statements of Polyphor Ltd and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements (pages 38 to 75) give a true and fair view of the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (ISAs) and Swiss Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We are independent of the Group in accordance with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code) and the requirements of the Swiss audit profession, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material uncertainty related to going concern
We draw attention to note 23 of the consolidated financial statements, which indicates the existence of a material uncertainty in respect of the need for sufficient financing to continue the business operations until final approval of Murepavadin and/or Balixafortide. This fact together with other matters disclosed in note 23 indicates that a material uncertainty exists that may cast significant doubt about the Group's ability to continue as a going concern if financing cannot secured. Our opinion is not modified in respect of this matter.

Responsibilities of the Board of Directors for the consolidated financial statements
The Board of Directors is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRS and for such internal control as the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements
Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and Swiss Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of our responsibilities for the audit of the consolidated financial statements is located at the website of EXPERTsuisse: http://www.expertsuisse.ch/en/audit-report-for-public-companies. This description forms part of our auditor's report.

Ernst & Young Ltd

Elisa Alfieri
Licensed audit expert
(Auditor in charge)

Eric Ohlund
Licensed audit expert

Balance Sheet as at 31 December 2017

	31.12.2017 CHF	31.12.2016 CHF
Assets		
Current assets		
Cash and cash equivalents	24'558'291	14'594'471
Trade accounts receivable from third parties	620'457	304'453
Other accounts receivable	1'358'862	1'245'797
Prepaid expenses	1'083'069	985'405
Total current assets	**27'620'679**	**17'130'126**
Non-current assets		
Financial assets (rent deposit)	447'221	447'159
Loan to subsidiary	19'431	4'460
Investment	1'470	1'470
Property, plant and equipment	4'359'677	5'242'228
Technology Platforms	7'779'400	13'552'725
Intangible assets	48'090	78'880
Total non-current assets	**12'655'289**	**19'326'922**
Total assets	**40'275'967**	**36'457'048**

Balance Sheet as at 31 December 2017

	31.12.2017 CHF	31.12.2016 CHF
Liabilities and shareholders' equity		
Liabilities		
Trade accounts payable to third parties	4'071'858	2'958'388
Current portion of debt	574'713	545'025
Other accounts payable	545'762	225'697
Prepayments	570'000	1'060'000
Deferred income / revenue	340'741	68'782
Short term provision	1'130'159	0
Accrued expenses	4'146'927	2'682'902
Current liabilities	**11'380'160**	**7'540'794**
Long-term portion of debt	4'258'074	3'326'305
Non-current liabilities	**4'258'074**	**3'326'305**
Total liabilities	**15'638'234**	**10'867'099**
Shareholders' equity		
Share capital	13'365'922	11'424'200
Legal capital reserves		
Reserves from capital contributions	163'063'228	125'602'233
Accumulated losses		
Loss carryforward	*-111'436'484*	*-90'242'776*
Loss for the year	*-40'354'933*	*-21'193'708*
Accumulated losses	-151'791'417	-111'436'484
Total shareholders' equity	**24'637'733**	**25'589'949**
Total liabilities and shareholders' equity	**40'275'967**	**36'457'048**

Income statement for the year 2017

	2017 CHF	2016 CHF
Income		
Revenue from services and collaborations	4'297'930	8'282'964
Revenue from product sales	1'040	367'804
Other income	100'000	0
Total income	**4'398'970**	**8'650'768**
Change in inventory, WIP and Technology Platforms		
Capitalized costs Technology Platforms	1'992'600	3'474'900
Total change in inventory, WIP and Technology Platforms	**1'992'600**	**3'474'900**
Expenses		
Cost of materials	-1'358'584	-1'783'578
Research and development expenses	-12'825'142	-9'915'639
Employee expenses	-16'147'722	-14'114'872
Other operating expenses	-7'044'961	-5'282'450
Depreciation and amortization	-8'830'920	-2'809'042
Total operating expenses	**-46'207'329**	**-33'905'581**
Operating income / (loss) before interest and taxes	**-39'815'759**	**-21'779'913**
Financial income	30'732	27'381
Financial expenses	-444'306	-226'002
Net foreign exchange gain / (loss)	-31'514	-24'724
Income for other accounting periods	0	867'150
Net income / (loss) before taxes	**-40'260'847**	**-21'136'108**
Tax expenses	-94'086	-57'600
Net income / (loss) for the year	**-40'354'933**	**-21'193'708**

Notes to the Financial Statements as at December 31, 2017

1. Accounting principles

These financial statements were prepared according to the provisions of the new Swiss Law on Accounting and Financial Reporting (32nd title of the Swiss Code of Obligations). Where not prescribed by law, the significant accounting and valuation principles applied are described below.

2. Information on Income Statement and Balance Sheet Items

2.1. **Other operating expenses** (in CHF)

	31.12.2017	31.12.2016
Legal, consulting and audit expenses	-1'889'769	-654'126
Patent & trademark expenses	-1'306'619	-1'111'846
Rent expenses	-1'201'401	-1'134'479
Other expenses	-2'647'172	-2'381'999
Total other operating expenses	**-7'044'961**	**-5'282'450**

2.2. **Restructuring**

On November 27, 2017, as part of its strategic realignment and focus on the Pharma Business, the Group committed to a plan to discontinue their Collaboration Services Business. The plan includes 34 redundancies per November 30, 2017. The majority of the employees who have been made redundant have a notice period running until February 28, 2018. Approximately 7 employees will remain until June-August in order to fulfil existing collaboration agreements. The restructuring does not affect Polyphor's research activities for its Pharma product pipeline. The restructuring also foresees that Polyphor will continue the sales of its Polyphor Libraries, however without offering employee-based collaboration support.

Following the announcement of the plan, the Group recognised a provision of CHF 1'130'159 for expected restructuring costs, including mainly employee termination benefits. The benefits are based on individual termination agreements between management and the individual employees. Estimated restructuring costs are based on the terms of the relevant termination agreements. The restructuring is expected to be completed by August 2018.

2.3 **Debt** (in CHF)

	31.12.2017	31.12.2016
Fixed loan	574'713	545'025
Total short term portion of debt	**574'713**	**545'025**
Fixed loan	2'751'591	3'326'305
Convertible loan	1'506'483	0
Total long term portion of debt	**4'258'074**	**3'326'305**

On February 3, 2017, a convertible loan of CHF 2'300'000 was made available to the Company. The pay-out of the convertible loan is split into several tranches, which are released after the achievement of predefined milestones. During the period under review, the company drew an amount of CHF 1'326'333.

Interest (3-month CHF LIBOR +2% p.a.) is accrued up to the earlier of (i) the date on which the loan is converted or repaid or (ii) the maturity date. The maturity date of the loan is February 3, 2024.

A conversion or repayment in cash within the first five years is only possible in two cases: listing of the Company's shares or default. The loan can be settled at the option of the lender through a variable number of equity shares based on the conversion price which is defined as a price per share at a discount of 20% to the share price at the subsequent listing.

2.4. Impairment of the Technology Platforms

During 2017 the Board of Directors decided to terminate the Collaboration Services Business which also uses Polyphor's Technology Platform for its business and hence the termination was identified to be an indicator for an impairment of the Technology Platform. The recoverable amount of the asset has been determined based on its value in use, by discounting the future cash flows to be generated from the sale of Technology Platforms to pharmaceutical companies. The recoverable amount of CHF 7'779'400 was lower than the carrying amount and an impairment loss of CHF 5'647'545 was recognised in the second half of 2017 (2016: nil).

2.5. Income for other accounting periods

The income for other accounting periods in 2016 of CHF 867'150 is related to a correction booking of the Technology Platform.

2.6. Participations

	31.12.2017	31.12.2016
Polyphor UK Ltd., London, United Kingdom (founded on 25th April 2012)		
Paid-in capital (GBP)	1'000	1'000
Amount of holding (%)	**100**	**100**

3. Other Information

3.1. Full-time equivalents

The annual average number of full-time equivalents for the reporting year, as well as the previous year, exceeded 50 and did not exceed 250.

3.2. Liabilities to pension fund

Neither at December 31, 2016 nor December 31, 2017 any liabilities to pension fund existed.

3.3. Restricted cash (in CHF)

	31.12.2017	31.12.2016
Rent deposit	447'221	447'159

3.4. Capital increases (in CHF)

	31.12.2017	31.12.2016
Share capital and legal reserves		
Share capital	13'365'922	11'424'200
Reserves from capital contributions	163'063'228	125'602'233
Share capital and legal reserves	**176'429'150**	**137'026'433**
Accumulated losses		
Loss carryforward	-111'436'484	-90'242'776
Loss for the year	-40'354'933	-21'193'708
Accumulated losses	**-151'791'417**	**-111'436'484**
Total shareholders' equity	**24'637'733**	**25'589'949**

In March 2017, the general meeting of shareholders approved a share split with the ratio 1:50. The existing 114'242 shares (including Common B-shares) with a nominal value of CHF 100 per share were split into 5'712'100 new shares with a nominal value of CHF 2 per share. The shareholders also approved the adjustment of the conditional share

capital in the amount of CHF 175'200 for the issuance of up to 87'600 fully paid in registered shares with a nominal value of CHF 2 per share (before share split: 1'752 fully paid in registered shares with a nominal value of CHF 100 per share).

During that general meeting the shareholders also approved the issue of 206'032 ordinary shares at an exercise price of CHF 48 per share ("Tranche 1") and the increase of the conditional share capital from CHF 175'200 to new CHF 491'234 for the issuance of up to 245'617 fully paid in registered shares with a nominal value of CHF 2 per share. This conditional share capital is exclusively reserved for the members of the employee stock option plan.

With regard to the convertible loan (see note 2.3) the general meeting of shareholders also approved an additional conditional share capital in the amount of CHF 119'800 for the issuance of up to 59'900 fully paid in registered shares covering a potential exercise of the conversion right.

The shareholders additionally authorized the Board of Directors to create authorized capital with the maximum amount of CHF 1'249'998 by issuing a maximum of 624'999 registered shares with a nominal value of CHF 2 each at any time until March 31, 2018 ("Tranche 2").

The Board of Directors was also authorized to create an additional authorized capital to the maximum amount of CHF 333'332 by issuing a maximum of 166'666 registered shares with a nominal value of CHF 2 each at any time until September 31, 2018. This additional authorized capital is exclusively reserved for Shareholders who fully participated in Tranche 1 and Tranche 2 of the capital increase which gives them the right until January 31, 2018 to purchase one additional share at a price of CHF 2 per share, for five shares already purchased in the two Tranches.

In July 2017 the Board of Directors decided to make use of the first authorized capital in the amount of CHF 1'234'770 by issuing 617'385 ordinary shares at an exercise price of CHF 48 per share.

In December 2017 the Board of Directors also decided to make use of the second authorized capital in the amount of CHF 294'888 by issuing another 147'444 ordinary shares at an exercise price of CHF 2 per share.

Based on the above figures if all legal reserves are included in the calculation of article 725 paragraph 1 CO, half of the nominal share capital and legal reserves are not covered by the net assets. However, if the capital reserves exceeding 50% of the nominal share capital are not considered in the calculation (i.e. those reserves which could be offset against accumulated losses), half of the nominal share capital and legal reserves are covered by the net assets.

3.5. Shares or options on shares for members of the Board and employees

In 2017 the following options on shares were allocated to members of the Board and to employees. The following information relates to the allocation in 2017 (valued at the fair value of CHF 35.29 for each option):

2017	Options Quantity	Options Value (CHF)
Allocated to employees	16'700	589'358
Total	**16'700**	**589'358**

In 2016 the following options on shares were allocated to members of the Board and to employees. The following information relates to the allocation in 2016 taking into consideration the share split of 1:50 (valued at the fair value of CHF 59.80 for each option):

2016	Options Quantity	Options Value (CHF)
Allocated to employees	58'000	3'467'785
Total	**58'000**	**3'467'785**

3.6. Material uncertainties and ability to continue operations

Polyphor's current funding is not sufficient to support the going concern assumption and the Company depends on further financing to ensure the continuation of its operations through the end of 2018 and to execute its strategy as outlined below.

The ability to continue business operations until final approval of murepavadin and / or balixafortide is contingent on the availability of sufficient financial resources. As a consequence, the Company has implemented restructuring measures to further reduce its workforce operational costs and its liabilities in connection with other obligations.

In addition, Management and the Board of Directors has initiated measures to secure additional financing by exploring possibilities of a capital increase, as well as sale or licensing of its assets. Polyphor has received expression of interest (nonbinding) from third parties. Whilst the Management and Board of Directors continue to apply best efforts to evaluate available options and take the steps described, there can be no guarantee that any transaction can be realized or that such transaction would generate sufficient funds to finance further operations.

The access to additional funds is decisive for Polyphor and its ability to continue operations and the absence of such a transaction would make it impossible for the Company to continue as a going concern. Under such circumstances, the Company would have to discontinue its business operations and could no longer apply the going concern assumption in preparing its financial statements for 2018.

The Board of Directors and Management of the Group have concluded that the combination of the above conditions and circumstances indicates the existence of a material uncertainty, which may potentially cast significant doubt about the Group's ability to continue as a going concern. Nevertheless, having assessed the situation, the Directors and Management believe that additional financing by exploring possibilities of a capital increase, as well as sale or licensing of its assets will be reached and the Group will be able to manage various business risks in uncertain and volatile environment and will be able to continue its operations for the foreseeable future in the normal course of business. For these reasons, they continue to adopt the going concern basis of accounting in preparing the Group's financial statements for the period ended December 31, 2017.

3.7. Events following the Balance Sheet date

In March 2017, the general meeting of shareholders authorized the Board of Directors to create authorized capital to the maximum amount of CHF 333'332 by issuing a maximum of 166'666 registered shares with a nominal value of CHF 2 each . This authorized capital is exclusively reserved for shareholders who fully participated in Tranche 1 and Tranche 2 of the 2017 capital increase which gives them the right until January 31, 2018 to purchase one additional share at a price of CHF 2 per share, for five shares already purchased in the two Tranches. In December 2017 the Board of Directors decided to make use of a part of the authorized capital in the amount of CHF 294'888 by issuing 147'444 ordinary shares at an issue price of CHF 2 per share. Until the end of the subscription period, a maximum of 17'155 shares can be subscribed for and be settled by Q2 2018. This would lead to a cash inflow of maximum CHF 34'310 for Polyphor and the issuance of 17'155 additional shares.

EY
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To the General Meeting of

Polyphor Ltd, Allschwil

Basle, 12 February 2018

Report of the statutory auditor on the financial statements

As statutory auditor, we have audited the financial statements of Polyphor Ltd, which comprise the balance sheet, income statement and notes (pages 80 to 86), for the year ended 31 December 2017.

Board of Directors' responsibility

The Board of Directors is responsible for the preparation of the financial statements in accordance with the requirements of Swiss law and the company's articles of incorporation. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements for the year ended 31 December 2017 comply with Swiss law and the company's articles of incorporation.

Emphasis of matter

We draw attention to note 3.6 of the financial statements, which indicates the existence of a material uncertainty in respect of the need for sufficient financing to continue the business operations until final approval of Murepavadin and/or Balixafortide. This fact together with other matters disclosed in note 3.6 indicates that a material uncertainty exists that may cast significant doubt about the Company's ability to

continue as a going concern if financing cannot secured. Our opinion is not modified in respect of this matter.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists, which has been designed for the preparation of financial statements according to the instructions of the Board of Directors.

We recommend that the financial statements submitted to you be approved.

Furthermore, we draw attention to the circumstance that half of the share capital and legal reserves is no longer covered (article 725 paragraph 1 CO). We refer to note 3.4.

Ernst & Young Ltd

Elisa Alfieri
Licensed audit expert
(Auditor in charge)

Eric Ohlund
Licensed audit expert

Imprint

March 2018

Overall Responsibility
Corporate Communications, Polyphor Ltd

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Dynamics Group AG

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