

Probi is here!

ANNUAL REPORT 2004



Probi in brief



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→ Probi was founded in 1991 and is now one of the leading companies in the field of probiotic research and development. The company's research focuses on live microorganisms with scientifically demonstrated health-promoting effects. The main therapeutic fields are gastrointestinal disorders, the immune system, cardiovascular diseases, and stress and performance recovery.

Probi's business is based on offering effective and thoroughly documented probiotic products and concepts, protected by comprehensive patents. This yields higher revenue levels than for the industry as a whole.

Probi has enjoyed a consistent income stream from commercialised products since the mid-1990s. Our customers comprise leading international companies in the fields of functional food, dietary supplements and clinical nutrition. Probi currently has four licensees for its probiotics, namely Danone, Skånemejerierna, Institut Rosell and Health World.

The global market for probiotic products is showing good underlying growth while new insights into the benefits offered by probiotics are boosting the market still further. Increased documentation requirements and official regulation are two trends that tend to give Probi an edge on its competitors.

Probi is based in Lund and has 17 employees. The Probi share has been quoted on the O-list of the Stockholm Stock Exchange since December 2004.

What are probiotics?

Probiotics are beneficial microorganisms that provide positive health-giving effects via the human intestinal tract. Studies show that there is a link between immunological defence and bacteria in the intestines. Effective probiotics can, for example, inhibit intestinal inflammations. Research into probiotics is relatively new, but there has been a marked rise in interest in recent years. Probiotic foodstuffs and dietary supplements now have an annual turnover of around SEK 60 billion internationally.

2004

- Net turnover totalled SEK 31.6 million (SEK 27.5 m). The result after tax was SEK -7.4 million (SEK -8.2 m).
- Cashflow totalled SEK 26.8 million (SEK 0.8 m). Liquid assets at the end of the year totalled SEK 46.9 million (SEK 20.1 m).
- Probi's partner, Institut Rosell, signed an initial distribution agreement for the launch of its new Probi product.
- Probi applied for a patent in a completely new therapeutic field.
- Probi presented a statistical analysis demonstrating that the company's clinical nutrition product reduces the number of infections in intensive care patients.
- The Probi share was quoted on the O-list of the Stockholm Stock Exchange. A new share issue for SEK 37.1 million was carried out.

SEK thousand	2004	2003	2002	2001	2000
Net sales	31,619	27,462	26,063	18,992	17,581
Operating result	-7,779	-8,528	-12,511	-13,957	-15,383
Operating margin, excl. R&D expenses, %	21.9	19.2	3.5	-15.5	-20.8
Net result for the year	-7,366	-8,180	-14,128	-11,925	-13,790
Shareholders' equity	83,709	58,341	66,521	80,649	92,639
R&D expenses, SEK	14,692	13,802	13,433	11,013	11,729
R&D, % of income	46.2	49.7	50.6	53.6	63.6

The CEO's statement



→ Probi's research is constantly progressing. We are continuing to develop new probiotic products in cooperation with our licensees and partners. At the same time, Probi has also moved into new areas, such as probiotic solutions for the medical sector – a move made possible by our thoroughly documented probiotics. The new research work strengthens our entire product offering and is being financed by the new share issue carried out by Probi in conjunction with the company's entry onto the O-list of the Stockholm Stock Exchange.

Investments in future royalties

The French company, Danone, one of the world's biggest suppliers of probiotic foods, has invested considerable resources in developing products that contain Probi's Lp299v bacteria. Probi has been involved in certain aspects of the development work and we are delighted that Danone now has a product solution containing our probiotics. As far as Probi is concerned, this signals the end of the development work and we are now awaiting Danone's other preparatory work relating to the formulation of a marketing concept ahead of the launch. Danone has launched and built up its two best-selling probiotic brand names, Actimel and Activia, very skilfully, and we therefore have high hopes for Danone's impending launch of its product containing Probi's bacteria.

The major success we have enjoyed in Sweden with fruit drinks, which are normally very difficult to combine with probiotic bacteria, constitutes one of Probi's strengths in relation to its competitors. Our successes with the fruit drinks

have given Probi a unique position in an area with tremendous international potential. Institut Rosell, our partner in the field of probiotic dietary supplements, has, over the past year, completed the development of a dietary supplement containing our probiotics and the product will be launched in the USA at the turn of the year. 2005 will also see Institut Rosell expand its launch into additional sales channels, as well as in a number of European markets. In the long term, this agreement – which covers North America and Europe – may be worth almost as much as our agreement with Skånemejerierna, i.e. around SEK 20 million a year.

Probi has also spent the past year completing a product concept in what is, for us, a new market area, namely probiotics for the medical sector, also known as clinical nutrition. Our aim is to achieve commercialisation during 2005 and to enter into an agreement with a medical sector supplier. Probi also has additional potential in the form of other bacterial strains that are well suited to this particular sphere of use.

Probi's research investments have thus largely been used not only to generate the royalty revenues that our existing agreements are expected to yield, but also to open up new fields for our probiotics in the medical sector.

High-quality probiotics

Probi currently has wide-ranging agreements with leading international suppliers of probiotics that will generate higher royalty revenues than elsewhere in the industry. The basis for Probi's successful commercialisation of its research is our ability to select robust bacteria that survive for longer in consumer products, coupled with our unique capacity for scientifically documenting and patenting bacteria with a probiotic effect.

Clear signs of our success in this area can also be seen in our partnership with Skånemejerierna. Skånemejerierna's probiotic ProViva products have recently encountered competition from several new probiotic foodstuffs, but have still performed extremely well. Skånemejerierna's ability to market a product-specific health claim, thanks to the properties of our bacteria and the scientific documentation we have produced, is an important factor in this success. To date, none of the products that compete with ProViva are able to produce equivalent documentation.

Flexibility is an important strength

Probi's close links to the world of research play an important role. Firstly, Probi's activities are based on one of the first probiotic discoveries relating to the *Lactobacillus plantarum* species – a legacy that we have successfully cultivated and developed with the aid of our highly skilled personnel and external research partnerships. Secondly, our agreements and partnerships with universities and other research institutions have given us a breadth and flexibility that permit simultaneous research in a number of different areas.

In 2004, we achieved rewarding results in our fundamental research work into probiotics. A meta-analysis of 230 patients showed markedly positive effects when Probi's probiotics were given to intensive care patients, and this was just one example. At the same time, our research network helped to highlight the potential for Probi's probiotics in the field of immunology. The positive findings of a study conducted at the Sahlgrenska Hospital in Gothenburg have, among other things, helped to ensure that Probi is now prioritising probiotic research relating to the immune system.

Strengthening our credibility

As we look to the future, we are working to secure and consolidate our position as one of the leading suppliers of high-quality probiotics, and this will lead to the signing of more agreements. The medical and pharmaceutical sectors impose more stringent demands on documentation and clinical tests than other sectors, and we believe that this can only strengthen our position.

Our research offers numerous exciting possibilities, one of which is the field of immunology, where we hope to obtain sufficient documentation to demonstrate that Probi's bacteria have positive effects on health in this important sphere. Commercially speaking, this could mean an agreement in new functional food areas within a couple of years. At the same time, I believe that Probi will be one of the best-positioned companies in a couple of years' time, when the EU is expected to regulate the scientific documentation required for health claims made in connection with probiotics. Given that the EU rules are designed to guide consumers' choices when faced with different product offerings, only the best-documented probiotic products will be marketable with specific health claims.

Probi is accordingly continuing to establish new patents in the probiotics field. The increased interest in probiotics and their health-giving effects among consumers and in the medical sector will strengthen Probi's position as a supplier of high-quality probiotics.

Both our employees and the researchers linked to Probi have helped ensure the company's successes. We believe that, as a result of the new share issue in conjunction with the share's listing on the Stockholm Stock Exchange in December 2004, we now have sufficient resources to fulfil Probi's ambitions and to develop successfully as a leading probiotics company.

Lund, March 2005


Per Bengtsson

Probi's business concept and objectives

→ BUSINESS CONCEPT AND MOTIVATION

Mission statement

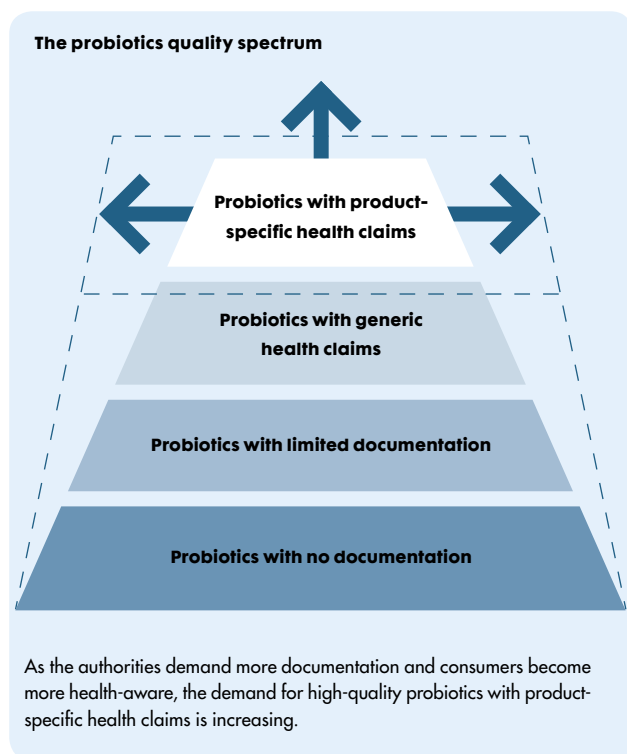
Probi shall be a leading research and development company that supplies industrial players in the Functional Food, Dietary Supplements and Clinical Nutrition market areas with commercially interesting product suggestions based on bacterial cultures with a probiotic effect.

Vision

Probi shall, through its research, be the most attractive partner and supplier of probiotic concepts for leading producers of probiotic products.

Values

Probi aims to create health-promoting product concepts that enable people to feel better, stay healthy and live longer.



BUSINESS CONCEPT

The business model in brief

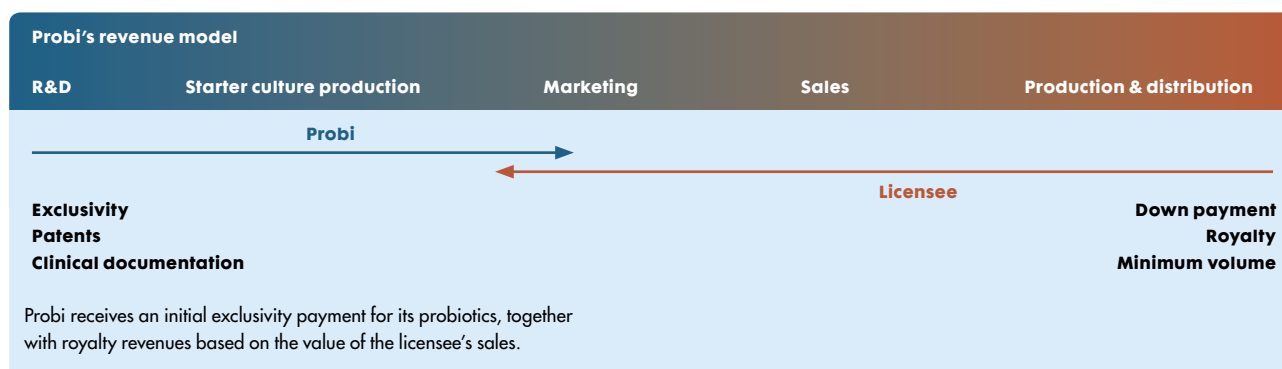
- Probi shall conduct research with a view to identifying, evaluating and clinically documenting interesting bacteria and probiotic concepts.
- Probi shall patent the results of its research to protect the use of its bacteria in a variety of therapeutic fields.
- Probi shall commercialise bacteria in return for royalty payments by signing licensing agreements with strong players.

Operational goals

- Probi shall retain its position as a successful supplier of clinically documented probiotics.
- Probi shall, through high-quality documentation and extensive patent protection, receive higher royalty revenues for its probiotics than the industry as a whole.
- Probi shall, within the next one to two years, sign licensing agreements with an international supplier of clinical nutrition products.
- Probi shall, within the next two years, develop and commercialise new product concepts for the food and nutrition market.

Financial goals

- Probi's organic growth in terms of net turnover during the next five years shall reach an average of 25 per cent per year.
- Probi's operating margin, excluding R&D expenses, shall be a minimum of 60 per cent. After a five-year period, R&D shall not exceed 30 per cent of income.
- Probi's result before tax for the year as a whole shall be positive within three years. The net margin shall exceed 25 per cent in the long term.
- Probi's cashflow shall be positive within three years, and shall subsequently total at least 50 per cent of the operating result.
- Over the next three years, Probi's operations shall be financed by means of shareholders' equity.





STRATEGIES

Research

Probi shall seek out, identify, evaluate and clinically document interesting bacterial strains and probiotic product concepts in the following therapeutic areas:

- Gastrointestinal disorders
- Cardiovascular diseases
- Immunological defence
- Stress and performance recovery.

Probi may also expand its research into other therapeutic areas if they are deemed to have commercial potential.

In order to identify and evaluate the probiotic effects of various bacteria, Probi shall engage in cost-effective research enabled, among other things, by partnerships with various academic research groups and the use of recognised research models.

Patenting and documentation

Probi's bacterial strains shall have comprehensive patent protection. The operations shall be analysed continuously to clarify the need for new patents and research.

In order to ensure that they are always regarded as the leading products in the field, Probi's probiotics shall be thoroughly documented, effective and clinically tested.

Commercialisation

Probi shall licence its probiotics to a limited number of players in order to achieve international distribution through best-selling products while keeping administrative costs low.

Probi's revenues shall comprise both an initial remuneration that covers Probi's development, customisation and production of licensed probiotics, and a royalty payment in relation to the ongoing sales of the end-product containing Probi's probiotics.

Quality

Probi's probiotics shall have a high level of survival in their end-product and shall maintain what is, for the industry, a high standard of scientific and technical documentation.

The credibility of probiotics

By expanding our operations to include clinical nutrition, i.e. probiotics intended for use in the context of medical care, where the requirements for scientific documentation are greater than in the food sector, for example, we can boost the credibility of Probi's probiotics. This will also enhance the company's status with other customer groups, e.g. within Functional Food.

The market

→ The market and market drivers¹

The quality of probiotic products varies depending on the documentation of the end-product's clinically proven health effects. The highest level is represented by probiotics with thoroughly described and documented bacteria with demonstrated effects on health. These thoroughly documented probiotics normally generate better revenue margins than other probiotics. Probi focuses on producing and supplying product concepts within this top-quality spectrum.

Probiotic products are primarily marketed and sold within two areas:

- Functional food via the food industry.
- Dietary supplements taken as a complement to ordinary food.

Probi is also interested in another important potential market segment:

- Clinical nutrition, where probiotics can be provided via nutrient solutions designed to meet a variety of requirements in the medical sector.

Today's market is primarily driven by the following forces:

- Research has yielded new insights into the benefits of probiotics. The number of published scientific articles on the subject of probiotics has increased over the past ten years from a handful to several hundred articles a year.
- Consumers' interest in health matters is growing, and there has also been a simultaneous increase in awareness of the effects of probiotics. Per capita consumption of probiotic foods has increased sharply in recent years.
- Companies in the food industry are

striving for higher profitability margins and growth via a range of health-promoting products.

- Authorities are keen to protect consumers through regulation. The Swedish action programme for the marketing of functional food adopted by the Swedish Nutrition Foundation will probably closely resemble the EU's regulations on health claims, which are expected to come into force in 2006. Society's efforts to cut medical and health care costs are also acting as an incentive to expand the use of probiotics with proven health effects.

Competitors

The primary competition faced by Probi in the market comprises players who supply end-product manufacturers with bacteria. The competition in the three markets where probiotics are mainly likely to find an outlet can be broken down as follows:

Licensers, such as Valio, Biogaia and, to some extent, Nestlé, which offer probiotic licences to Probi's potential customers.

Ingredient suppliers, such as Chr. Hansen and Danisco, which offer bacteria in the form of input goods.

The research and development departments of major probiotic product manufacturers and distributors, such as Danone and Yakult, provide yet another form of competition, in the sense that Probi and other licensers must be successful in competition with these departments' in-house development.

The health-giving properties of probiotics

Probiotics – living microorganisms with scientifically demonstrated health-giving effects – have become a wide-ranging research field in the past decade. As immunological and gastrointestinal disorders have grown increasingly common, interest has also grown in maintaining a balance between healthy and pathogenic bacteria in the body. The probiotic bacteria contained in a variety of products have been shown to counteract the negative effects of increased use of antibiotics, rising stress levels and an increased tendency among severely ill patients to develop infections, as well as deteriorating dietary habits and industrially processed food.

New research has shown that probiotic bacteria protect the outer layer of cells in the intestinal mucosa and thereby boost the barrier function of the intestines.

Various studies have also shown that effective probiotic bacteria inhibit intestinal inflammation and that there is an interaction between the immune system and the bacteria in the intestine.

Many probiotic bacteria are part of the lactobacilli family (lactic acid bacteria), but not all of them work equally efficiently. The most effective bacteria seem to use a variety of mechanisms of action to mediate their effects. International interest in research into probiotic bacteria with medically valuable effects is growing. There are still no formal international requirements, however, with regard to what may be called a probiotic – such regulations currently exist at national level only. Japan and Sweden are among the countries where probiotics are most firmly established.

¹ All estimates of market size in SEK in this section have been recalculated using exchange rates of SEK 7.50 per USD and SEK 9.15 per EUR.

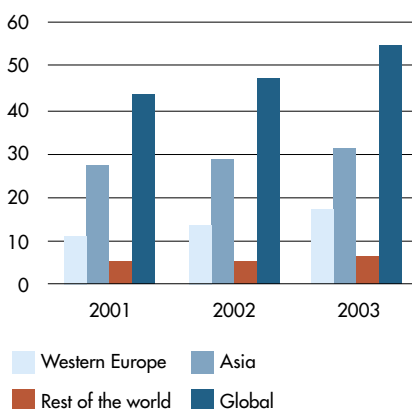
FUNCTIONAL FOOD BUSINESS AREA

The term “functional food” refers to food products that have been enriched with ingredients that have positive effects on health over and above the normal nutritional value of the food. Probiotic foods comprised 18 per cent of the global functional food market in 2003, and had a retail turnover of approximately SEK 55 billion. Products made by the Danone and Yakult food companies account for almost half of this market. The average annual growth rate for probiotic foods between 2001 and 2003 was just over 12 per cent, in comparison with the average annual growth rate for the food market as a whole of approximately 6 per cent during the same period². Probi believes that the growth rate will in future be on a par with that seen in recent years.

Probiotic foods are currently dominated by dairy products, such as yoghurts and milk drinks. The expectation is, however, that their use will in future expand to cover a wider range of products, including a variety of fruit drinks. To date, however, only a few producers of probiotics worldwide, of whom Probi is one, have successfully developed attractive probiotic concepts for drinks, due to the fact that such drinks are often a challenging environment in

²Euromonitor, “The world market for functional food and beverage”, Jan. 2004. Euromonitor, IMIS Database 2004.

Sales of probiotic functional foods, 2001–2003, SEK billion retail



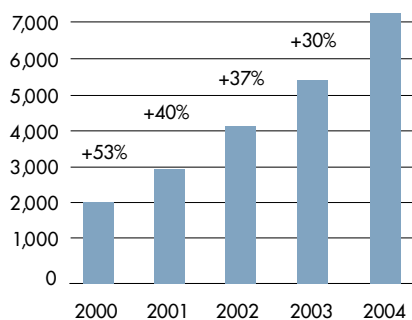
which bacteria find it hard to survive. Internationally speaking, the highest per capita consumption of probiotic foods is to be found in Japan. This is due in part to the fact that probiotic drinks have been available in Japan for several years now, as well as to the fact that many Japanese have a positive attitude to the effects of probiotics. Japan also has a highly developed regulatory system that makes it easier for the consumer to choose between different types of probiotics.

The use of probiotics has grown more rapidly in Europe than in the rest of the world in recent years. The trend is being fuelled by extensive marketing on the part of the major producers of probiotic foods, including Danone with its Actimel product. Danone’s Actimel is currently sold in just over 20 countries, and in 2004, it reported a turnover of almost SEK 7.2 billion. Danone has estimated that Actimel will achieve a turnover of just over SEK 9 billion in 2006.

Innovative Swedish and Finnish dairy products, backed by strong research, have also helped boost interest in probiotics.

Probi’s partner, Skånemejerierna, reported a retail turnover of almost SEK 300 million for its ProViva product range, which contains Probi’s bacteria. This figure corresponds to half of one per cent of the global probiotic functional food market.

Sales trend for Danone’s Actimel SEK million in producer prices



Future products and spheres of use

Current development work on methods of adding bacteria to non-chilled foodstuffs, such as cornflakes or bread, is of interest for future consumption patterns.

Gastrointestinal complaints are at present the therapeutic area where there is the greatest demand for probiotic food products. Other therapeutic areas will be of interest in the future, such as cholesterol reduction, infections, effects on the immune system and inflammatory conditions, blood pressure reduction, and other areas involving human metabolism, such as carbohydrates and fat.

Regulations

A number of countries have chosen to regulate the ways in which functional food may be marketed, the aim being to protect and guide consumers. The evaluation of the scientific documentation that underpins a health claim is an important goal in this context. Japan and Sweden are among the countries to have progressed furthest in the regulatory sphere, but only a few countries within the EU have so far formulated regulations governing health claims, and these regulations vary from one country to another. A new set of regulations that will apply throughout the EU is, however, being drafted and is expected to resemble the Swedish system, where product-specific claims for functional foods are approved by the Swedish Nutrition Foundation. Products, such as probiotics, can be divided into three tiers:

- Foods with product-specific health claims.
- Foods with general health claims.
- Foods without approved health claims, but with a clear health-oriented positioning.

There is currently only one probiotic product in the uppermost tier, namely ProViva, which contains Probi’s probiotics.

The market

DIETARY SUPPLEMENTS BUSINESS AREA

Dietary supplements are foods designed to complement a normal diet and they are sold in the form of capsules, tablets, portion packs etc. They include everything from simple products, such as vitamins and herbs, to more highly refined and documented products.

The global market for dietary supplements totalled SEK 450 billion in 2003. Probiotic dietary supplements accounted for a very limited section of this massive market, or a mere SEK 5 billion, with the majority sold in the USA and Europe. Probiotic dietary supplements are, however, experiencing rapid growth, averaging 11 per cent between 2001 and 2003. The future growth rate will, in Probi's view, be on a par with that seen in recent years. The market is fragmented – in the USA and Europe, the three biggest players accounted for only 10 to 15 per cent of sales³.

In the USA, probiotic dietary supplements are primarily sold via health food stores and specialists, and via direct sales to end-users. The American market for probiotic dietary supplements is slightly larger than that for probiotic functional foods.

Italy is the largest European market, followed by France and Germany. Only a few nutrition companies have sales in more than one country, and the majority

³Analysis by Health Strategy Consulting, 2004. Estimate based on Nutrition Business Journal 2004, local market statistics and interviews with industry experts.

of probiotic dietary supplements are sold through pharmacies.

The Japanese market for probiotic dietary supplements is still small in comparison with the Japanese functional food market, and the majority of sales take the form of door-to-door selling or mail order.

Future products and spheres of use

Today's probiotic dietary supplements are primarily aimed at the therapeutic area of gastrointestinal disorders. In future, however, we expect dietary supplements to be launched in areas such as immunological defence and allergic and cardiovascular diseases, and to account for a growing share of turnover. Different types of combination products will probably also be developed, such as combination products of vitamins and probiotics and combinations of probiotics (bacteria) with prebiotics (fibres).

Regulations

The market for probiotic dietary supplements is still characterised by different local conditions with regard to legislation and distribution. The lack of international regulation makes it difficult to carry out international registrations and launches, and very few products have consequently achieved widespread distribution. Within the EU, there are directives governing the content lists of dietary supplements, and as a result, new regulations issued by the Swedish National Food Administration will come into force in Sweden in 2005.

These regulations do not, however, as yet include any rules governing health claims.

CLINICAL NUTRITION BUSINESS AREA

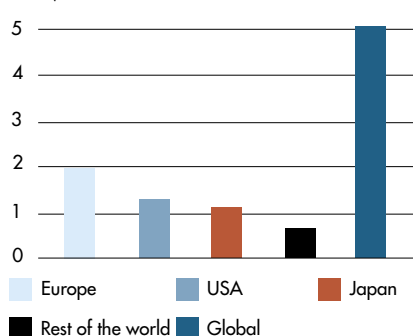
The term "clinical nutrition" refers to specialised nutritional products intended for use in inpatient and outpatient care. The products are generally prescribed by physicians for specific health-related purposes.

Global sales statistics for clinical nutrition products are limited, but in 2003, the market was estimated at approximately SEK 35 billion at the producer stage of the chain⁴. The USA accounts for one third of this market, and the fact that American health care costs are higher per capita than elsewhere in the world has led to a search for ways of cutting treatment times, e.g. via the use of nutrition. The growth rate between 2001 and 2003 in this sector is estimated at 5 per cent per annum⁴.

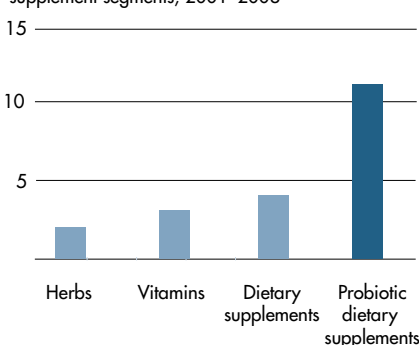
There are currently no clinical nutrition solutions that contain probiotics, partly due to the fact that interest in probiotics is relatively new in the medical sector, and partly due to the fact that it takes several years to develop a commercially

⁴The market estimate is based on Probi's analysis of the sources in material obtained from Abbott, Novartis, Fresenius-Kabi, Numico and Nestlé, internal information, and interviews with industry representatives.

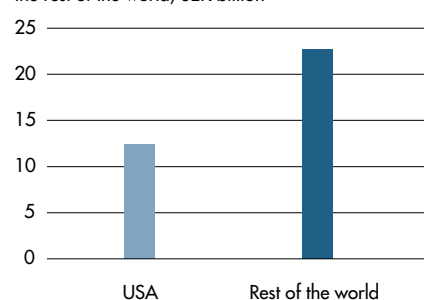
Global sales of probiotic dietary supplements, 2003, SEK billion



Average annual growth rate (%) for dietary supplement segments, 2001–2003



Clinical nutrition sales in the USA and the rest of the world, SEK billion



successful product that meets the requirements of the medical sector and the authorities. Probiotic nutrient solutions are taken orally, and hence come under the heading of enteral nutrition – an area whose value comprises two thirds of all clinical nutrition used.

The factors providing the driving forces behind clinical nutrition products containing probiotics are primarily expected to be as follows:

- Demands for shorter treatment times and reduced use of antibiotics.
- Efforts to reduce infections and complications resulting from surgery.
- New opportunities to inhibit inflammations.
- Increased knowledge and documentation of the health effects of probiotics.
- An ageing population with a growing number of patients requiring enteral nutrition.

Future products and spheres of use

Clinical tests of probiotics used in clinical nutrition have shown excellent potential for both improving health and saving money in the medical sector. The bacterial flora of patients in the intensive care units of hospitals is often substantially reduced as a result of courses of antibiotics etc. This allows pathogenic bacteria to emerge and cause complications, such as diarrhoea, inflammations or serious infections such as blood poisoning. The use of probiotic enteral nutrition that restores the bacterial flora in the patients' stomachs can be helpful in this context. Surveys show that savings of 1–2 treatment days can be made, corresponding to SEK 25,000 per day.

There are numerous illnesses where established pharmaceutical therapy can have side-effects on the gastrointestinal system. This is true, for example, of cytostatic treatment (chemotherapy)

and radiation, where probiotics are a useful complement in retaining good intestinal functioning. Probiotics also have excellent potential with regard to a number of other groups of diseases, such as a weakened immune system, pancreatitis, HIV, inflammatory bowel disease and malnutrition in the elderly.

Regulations

The regulations and documentation requirements governing clinical nutrition products are considerably less extensive than those applying to pharmaceutical products. The former are classified as “foodstuffs for special medical purposes”, reflecting the fact that food is perceived as being generic, and more extensive review is therefore not required. Extensive clinical trials are required for more advanced clinical nutrition, e.g. products containing probiotics, both in order to command a higher market price and in order to ensure that the cost is subsidised. The medical and health-economic advantages of clinical nutrition containing probiotics must therefore be documented.

Rules governing the marketing of clinical nutrition are currently only in place at the national level. In Sweden and the majority of other European countries, providing information on the medical benefits of a nutrition product is permitted. At the same time, extensive documentation is required for the product so as to ensure that it can be marketed efficiently and receive the subsidies to which nutritional products are normally linked.



Probi's probiotics are currently found in Skånemejerierna's ProViva range of products and in dry dietary supplements from Institut Rosell, among other products. Developing probiotics that survive in difficult environments is one of Probi's distinguishing features. Our probiotics survive for weeks in fruit drinks and can cope with the passage through the human digestive system. They are then able to establish themselves in the gastrointestinal tract, where they help improve the consumer's health.

The operations

→ Background

Probi is a pioneering company in the field of probiotic research and development. Way back in 1986, Probi's founders began a research project at Lund University with the aim of developing a new nutritional supplement to be given to seriously ill patients. At that time, researchers had extremely limited knowledge of the importance of the intestinal flora to an individual's general health, and the project was therefore very much a visionary one.

Since then, research progress has enabled Probi to establish itself as a leading company in the field of probiotic research and development. Probi has extensive clinical documentation for its probiotics and has several commercial agreements with international manufacturers of probiotic products.

The *Lactobacillus plantarum* 299v and 299 bacteria are currently the bacterial strains that form the core of Probi's operations. Probi is conducting research into a wide variety of probiotic bacteria, but the company's most extensive documentation and experience relate to Lp299v and Lp299. These bacterial strains are two of the few to have been tested scientifically on humans and to have been shown to survive the passage through the acidic environment and breakdown enzymes of the digestive system and subsequently establish themselves and function for several days in the gastrointestinal tract.

Organisation

Probi today is a small but efficient organisation comprising 17 employees. Additional competence and capacity are secured by means of cooperation with research partners at Swedish and international universities, with consultants, and with customers.

The company offers probiotic bacterial strains and product concepts to customers in three distinct business areas, namely Functional Food, Dietary Supplements and Clinical Nutrition. Probi foresees a requirement to strengthen its organisation in the future, initially in the form of sales and licensing resources etc., in order to meet the increased requirements arising in conjunction with the establishment of the Clinical Nutrition business area.

Business model

Probi's research aims to identify and document interesting probiotic bacterial strains. The usefulness of the bacteria is tested in various spheres of application, e.g. for gastrointestinal disorders or cardiovascular diseases in humans. The most viable findings are patented – both the bacteria and their application. Clinical trials are conducted within Probi with regard to the survival of the bacteria in the stomach. The next stage involves documenting the effects through clinical studies in a range of therapeutic areas. The goal is to find robust probiotic bacteria with a high survival rate, both in the products in which they are delivered and in the human gastrointestinal system. When coupled with the company's solid

documentation of the bacteria's effects in various therapeutic areas and effective patent protection, Probi's probiotics shall generate significantly higher royalty levels than in the probiotic industry as a whole.

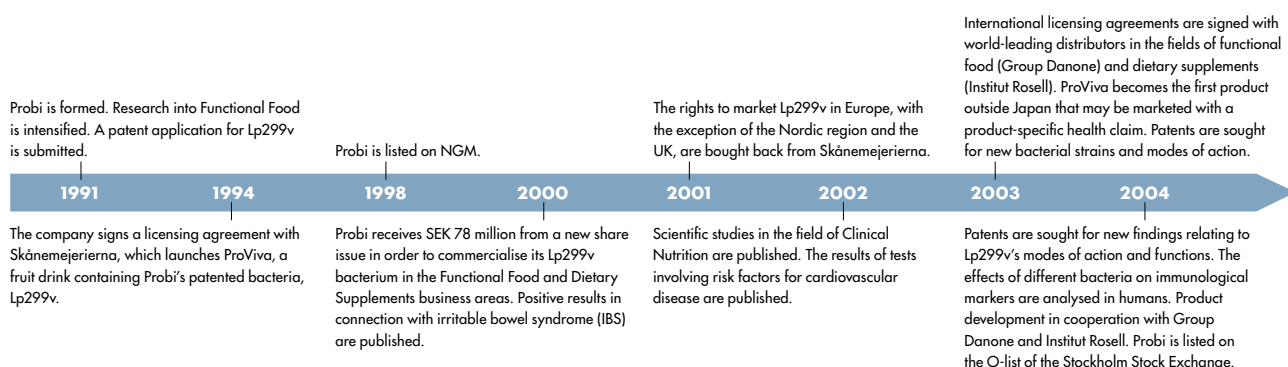
The customer strategy involves signing exclusive licensing agreements with a small number of demonstrably successful international manufacturers of probiotic products. Probi assists its customers by providing research competence and advice during the product development phase.

Revenues are based on an initial one-off payment and subsequent royalty payments in relation to sales. The model is similar to the one customarily employed in the pharmaceutical industry. The royalty rates vary between Probi's business areas and are expected to rise as the demands for documentation become more extensive. Agreements in the field of Clinical Nutrition are thus expected to generate higher royalty revenues than those within Dietary Supplements and Functional Food.

Probi's competitive advantages

Probi focuses on bacteria with excellent survival potential, strong documentation, and comprehensive patent protection.

Probi's first generation of bacteria comprises robust bacteria with a broad range of uses. Probi thus offers bacteria for a broad portfolio of products, ranging from yoghurt and ice cream to a variety



of dietary supplement variants, fruit drinks and nutritional solutions. The bacteria also have a high survival rate in the acidic environment of the stomach.

Probi's Lp299v bacterium, for example, has more documented health-giving effects than any other probiotic. Overall, Probi is well equipped to handle the new EU regulations that are due to be introduced for probiotics. Skånemejerierna's ProViva product range, which contains Probi's Lp299v bacteria, received approval for product-specific health claims in 2003 and Probi regards this as a good indicator that its research lives up to the impending requirements.

Probi's patent protection for the bacterial strains and the applications linked to them provides licensees with strong probiotic products. Probi monitors its patents continuously for infringements with a view to maintaining the market exclusivity that a patent is designed to give to licensees.

Research and development

When Probi was founded, it brought together expertise in the fields of surgery, food technology and microbiology. Probi still works in these areas today, partly via Swedish researchers and partly via international universities with which Probi has forged links through a variety of partnerships.

Probi strives to maintain a continuous project flow in its research work. A structured research and development process is applied, from initial explorative research to launch. The bacteria are tested on a laboratory scale and suitable bacteria are selected. The bacteria's properties are then characterised with the aid of a variety of test methods.

Selected bacteria then undergo additional testing. Phase one of the clinical trials entails identifying and characterising interesting bacteria that meet important requirements, such as survival in the gastrointestinal tract and the absence of side-effects. In this context, Probi applies models similar to those used in the pharmaceutical



Probi is here!

Probiotics are bacteria that have positive effects on human health. Probi has shed new light on the beneficial effects of bacteria and has patented strains with thoroughly documented effects on health. Our Lp299v bacterium, for

example, has more documented health-giving effects than any other probiotic in connection with IBS (irritable bowel syndrome) and intestinal infections, for example.

The operations

industry in order to identify and evaluate the probiotic effects of bacteria. Probi's clinical trials then enter phase two, where tests are conducted on a small group of patients with the help of the company's partnerships with various academic research groups. This enables the effects of Probi's probiotics to be further documented. The goal of the clinical studies is approval for a product-specific health claim.

In the final stages of the process, Probi's customers develop the consumer product, normally with the assistance of Probi in the form of documentation and experience. Clinical trials are therefore usually only carried out on Probi's probiotics in phases one and two before commercialisation, unlike the pharmaceutical industry, where a successful phase three study is required before a product can be approved by the pharmaceutical authorities.

Probi's research focuses first and foremost on four therapeutic areas. The best documented of these areas are the effects on gastrointestinal disorders, where Probi's Lp299v bacteria have been shown, among other things, to alleviate complaints related to IBS (irritable bowel syndrome). Extensive research work is also conducted in other therapeutic areas, such as immunological defence, cardiovascular diseases and stress. Probi is also able to conduct research outside these therapeutic areas if it is considered commercially interesting, since the company's network of research contacts provides extensive research capacity and access to niche competence.

During 2004, Probi has chosen to prioritise research into effects in the field of immunology. This research has included immunological studies on humans, during which a variety of bacteria have displayed interesting effects on the immunological defence system. Probi expects to be able to commercialise future results in the Functional Food business area.

Probi has also documented additional important properties relating to the effectiveness of its patented Lp299v bacterium, including effects in therapeutic areas in which Probi has not previously recorded any indications for the bacterium. One aspect of Probi's research that has attracted particular attention was presented at the Biotech Forum trade fair in Copenhagen in 2004, where findings in connection with Lp299v and its anti-inflammatory effects when combined with fruit extract were described. The findings are deemed to have considerable potential for commercialisation over the next few years.

Probi's research work during the year has also focused on its product development partnerships with Danone and Institut Rosell, as well as on documenting a number of new bacterial strains and product concepts.

Research and development expenses in the past five years have increased by 26 per cent to SEK 14.7 million in 2004. Expressed as a percentage of Probi's income, these expenses have fallen from 64 per cent to 46 per cent.

Research and development areas	Indications
Gastrointestinal disorders	IBS (irritable bowel syndrome) IBD (inflammatory bowel disease) Gastrointestinal infections and surgery Side-effects of cytostatic treatment
Immunology	Immune system modelling HIV
Cardiovascular disease risk factors	Risk factors for cardiovascular disease, e.g. fibrinogen, cholesterol, blood pressure
Physiological stress, performance recovery	Physiological stress Antioxidative capacity

Research work currently in progress within the Functional Food and Dietary Supplements business areas

Gastrointestinal disorders

A number of projects focusing on new modes of action and new bacteria are under evaluation. Two concepts are at the patent application phase and will not be commercialised until 2006 at the earliest.

Immunology

Bacteria are being charted with regard to their effects on the immune system. Probi's new results indicate that different bacteria have different effects on the human immune system. The activities are providing both answers to questions concerning the mechanisms of action in question, and ideas for specific projects involving new or established bacterial strains. Clinical studies can begin in 2005.

Cardiovascular diseases

Two different mechanisms are currently being investigated. The results may be of significance with regard to the metabolism of fats and carbohydrates. Probi will decide on possible product concepts in 2005 and commercialisation can then be discussed with partners.

Inflammation

One recently developed bacterium has, in trial models, shown itself to have a greater suppressing effect on inflammation than Probi's previous bacteria. Various spheres of use and combination possibilities are being considered. Clinical studies can commence in 2005.

The importance of the formulation for the probiotic effects of bacteria

Laboratory data has demonstrated interesting combination effects that may have applications in several different projects. The work is still in an early phase.

Fundamental bacterial evaluation

Fundamental research work involves research to determine the probiotic mechanisms of the bacteria. Combinations of bacteria are studied in order to identify any benefits in comparison with individual bacterial strains. A number of new bacteria of various types have been developed and may prove suitable for a range of projects within Functional Food and Dietary Supplements. A selection will be made once fundamental effects have been charted.

Current research work in the Clinical Nutrition business area

Intensive care project

The first product concept is ready to be offered to potential customers. Commercialisation is expected in 2005 at the earliest.

Nutrition project

Still in an early phase. The project's later phases may be conducted in cooperation with Clinical Nutrition partners.

Patents

Patents provide value and protection for both Probi and the company's customers, and Probi accordingly allocates substantial resources to effective patent protection for its research. Probi now holds five patented probiotic strains and nine patents with regard to the probiotics' effects. The company has a total of 93 taking into account all its geographic markets. From a pharmaceutical perspective, probiotics have long effective patent durations because the development time for probiotic preparations is normally only half that for pharmaceuticals. The patent portfolio is analysed regularly from a strategic viewpoint with a view to optimising the existing protection, e.g. via documentation and studies.

As a general rule, licensing revenues are determined by the effective patent duration, i.e. the patent duration remaining when the product is launched. Broad commercial agreements often include numerous patents, however, and when this is the case, Probi has sought solutions whereby royalties are paid with no reduction for as long as there is a patent in force. The strain patent for Lp299v is the most important patent in terms of Probi's existing commercial agreements and is due to expire in 2012. Probi expects, however, to continue to receive licensing revenues for approximately 10 years or so after this date, in line with the company's agreements with its partners.

In 2004, Probi applied for a patent in a new functional area that is considered to have potential in terms of generating new product concepts within functional food. Patent applications have also been submitted for new bacterial strains that have demonstrated interesting properties with possible applications in all of Probi's business areas.

Operating expenses

Probi's primary expense items comprise its personnel costs, research and development expenses (such as clinical studies and documentation) and patent costs. The company's operating expenses over the past five years have increased by 18 per cent to just under SEK 40 million in 2004. Over the same period, income has increased by 80 per cent to just under SEK 32 million.

FUNCTIONAL FOOD BUSINESS AREA

Functional Food	2004	2003
Turnover, SEK m	29.6	26.4
Percentage of total income, %	93	96
Operating result, SEK m	5.1	2.1

Probi offers thoroughly documented probiotic bacteria to food producers with a strong position in the sphere of functional foods. Probi has conducted clinical trials on a number of different probiotic bacteria and has successfully documented clear health effects on gastrointestinal disorders and stress and performance recovery. The trials relating to cardiovascular diseases and immunology have also yielded promising results, but these therapeutic areas will require additional studies and documentation before commercial exploitation is possible.

Probi's existing customers are food companies that distribute chilled products. As the probiotic bacterial strains and product solutions are made more stable, they may also be

considered for use as additives in room-temperature foodstuffs, such as bread or cornflakes. Probi's best-documented bacterium, Lp299v, has demonstrated an excellent capacity to survive in acidic environments, and thus offers considerable potential for uses outside the more common sphere of milk-based products.

Danone

In 2003, Probi signed a licensing agreement with Danone, the world's biggest supplier of chilled dairy products with an annual turnover of EUR 13.5 billion. Danone has achieved a strong position in the market of probiotic functional foods in recent years and the company now has two strong probiotic foodstuffs, namely Actimel and Activia/Bio. Danone has also made substantial investments in other probiotic food companies, such as the Japanese firm, Yakult, and the American firm, Stonyfield Farms.

The licensing agreement gives Danone exclusive rights to sell certain types of food product that contain Probi's Lp299v bacteria. Danone's food products may include fruit- and vegetable-based drinks, water-based drinks and chilled dairy products. The exclusivity is global, with the exception of the Nordic region and the UK.

During 2004, Danone has continued to develop a probiotic food product containing Probi's probiotics. Probi has assisted Danone's technical development work by providing technology and test methodologies. The project has made major progress and Danone developed several products during the latter part of the year. The project has now reached a phase where a marketing concept is being developed and a launch is being planned, although Danone has not yet announced a launch date.

The operations

Skånemejerierna

Skånemejerierna started manufacturing and distributing the ProViva health drink in 1994, and it has been a sales success in Sweden ever since, with healthy growth in turnover reported for the ProViva brand name every year. Retail sales of ProViva totalled almost SEK 300 million in 2004. ProViva contains Probi's Lp299v bacterium and is currently available in the form of fruit drinks, fruit shots and yoghurt, although Skånemejerierna is planning to augment the range with new products. Under the current agreements, Skånemejerierna is allowed to manufacture various types of food product containing Lp299v for sale in the Nordic region and the UK. Probi has a fixed royalty rate in relation to Skånemejerierna's sales of products containing Probi's Lp299v.

The partnership with Skånemejerierna has been important to Probi for a number of reasons. Among other things, ProViva's success in Sweden has confirmed Probi's commercial potential internationally. After a review by an international committee of experts, ProViva has also been granted approval as the only probiotic product in Sweden permitted to make a claim regarding the specific health effects of the product.

DIETARY SUPPLEMENTS BUSINESS AREA

Dietary Supplements	2004	2003
Turnover, SEK m	2.1	0.2
Percentage of total income, %	7	1
Operating result, SEK m	-1.2	-2.0

Probi offers thoroughly documented probiotics to strong manufacturers and distributors of dietary supplements.

Probi's strategy within the field of dietary supplements is to commercialise the bacterial strains that have proven successful in the sphere of functional foods. The aim is to enter into agreements with leading players in a range of geographical markets. Probi currently has strong documentation for its probiotics, which can be used as dietary supplements to counteract gastrointestinal disorders. In its agreements, Probi reserves the right to sign new and exclusive agreements for the same bacteria in the same markets but in other therapeutic areas.

Probi primarily targets pharmaceutical companies with non-prescription products, nutrition companies and companies that have established sales channels to the above.

Institut Rosell

In the autumn of 2003, Probi signed a licensing agreement with Institut Rosell, the biggest supplier of probiotic dietary supplements in the USA and Europe. Institut Rosell has previously enjoyed successes with the launch of dry probiotic products.

The agreement gives Institut Rosell the right to market and sell dietary supplements in the form of capsules, tablets and sachets containing Probi's Lp299v bacterium in North America and within the EU. The agreement also gives Institut Rosell the exclusive right to market dietary supplements in the therapeutic area of IBS (irritable bowel syndrome). In 2004, Institut Rosell, working in partnership with Probi, developed a dietary supplement containing Lp299v with a very long shelf life at room temperature. At the end

of the year, Institut Rosell reached an agreement concerning a first delivery of the capsule to the distribution company, Phillips Health Inc., which will launch the product in the American market. Institut Rosell will continue to launch the product via additional sales channels and in other markets in 2005.

Once the launch is completed in full, the agreement with Institut Rosell is expected to generate income for Probi of around SEK 20 million per annum.

Health World

In the spring of 2003, Probi signed an agreement with Health World, Australia's biggest supplier of probiotic dietary supplements. The agreement gives Health World the right to sell dietary supplements containing Lp299v in Australia and New Zealand. The products include powders and capsules that can be marketed exclusively in the therapeutic area of IBS.

Health World gives Probi access to one of the world's most developed markets for natural preparations and health foods. By the end of 2004, Health World had developed and distributed two different dietary supplement products containing Probi's probiotics.

CLINICAL NUTRITION BUSINESS AREA

Clinical Nutrition	2004	2003
Turnover, SEK m	0	0
Operating result, SEK m	-5.8	-2.1

In the Clinical Nutrition business area, Probi offers probiotic concepts for use in nutrient solutions used in the medical sector. By the end of 2004, Probi had a concept in the late phase of development which, with minor adjustments, can be modified into a finished product. The concept targets the most highly specialised segment of intensive care and has undergone clinical trials in well defined patient groups, such as patients with acute pancreatitis. The concept is based on Probi's Lp299v bacterium. A meta-analysis of previous clinical studies

comprising 230 severely ill patients was presented at this year's biggest European congress in the field of clinical nutrition, ESPEN. The results underline the fact that Probi's first product in the clinical nutrition sphere constitutes a valuable addition to the arsenal used in reducing the number of infections in conjunction with intensive care treatment. When Probi's probiotic was given to these patients, only 10 per cent of them suffered infections, in comparison with 39 per cent in conjunction with conventional therapy.

Probi currently has no licensing agreements, but the intention is to sign agreements in 2005 with a major player in the field of clinical nutrition. Potential customers primarily include nutrition companies and pharmaceutical companies providing nutrition products. Probiotics are not at present used as part of nutritional solutions, but Probi sees the potential for change in this respect, particularly given that Probi can offer clinical documentation of its research findings.

The ongoing strategy in Clinical Nutrition entails an expansion of the product concept into other therapeutic areas, such as inflammatory bowel disease, disruptions of intestinal motility, excessive bacterial growth in the intestine and cancer. Probi also intends to develop completely new probiotic concepts. In the long term, Probi will offer probiotics for clinical nutrition in a large number of care concepts.

The business area is expected to start generating revenue one year after the first agreement is signed. Probi's continued investment in clinical nutrition is thus not likely to generate income until the end of 2007 at the earliest. In general, it is estimated that the business area will be capable of generating higher royalty revenues than the other business areas.



Probi is here!

Here at Probi, we are seeing a growing interest within the medical sector in medical treatments that use probiotics. Treatments of this kind can, for example, reduce problems in conjunction with infection and surgery. One of our main

fields therefore involves developing probiotics for enteral nutrition and generating scientific documentation that complies with the medical sector's requirements in terms of medical effects.

Probi's employees

→ Researchers with doctorates

Probi's operations focus on probiotic research, and Probi has consequently, among other things, invested heavily in attracting staff with in-depth research experience. The company employs research personnel with experience in the fields of medicine, microbiology and food chemistry. Seven of the company's 17 employees have doctorates. Probi's headquarters are located in the Ideon Research Park in Lund – a location that enables researcher exchanges and contacts between universities and companies in a stimulating environment.

Over and above its research organisation, Probi also has marketing, finance and administration, production, product development, and business development functions. In terms of gender breakdown, the company's employees included nine women and eight men at the end of 2004. No employees left the company during the year, but two new members of staff were recruited. The age distribution was as shown in the table below.

	20–30	31–49	50–
Age distribution	12%	65%	23%

Necessary flexibility

Given its relatively small number of employees, Probi's organisation must be flexible if it is to be able to conduct successful research and commercialisation within several different therapeutic areas. Probi accordingly strives to maintain an open dialogue within the company and to support a continuous exchange of knowledge between different functions. The ability of Probi's employees to familiarise themselves quickly with the work already performed is also crucial, and Probi thus emphasises the importance of detailed documentation of the progress made by the company in a range of areas.

Probi strives to create a workplace that is attractive to both existing and prospective employees. The company's commercial successes have helped bring about a clear increase in interest in Probi as an employer, and numerous people have contacted Probi during the year, both to seek employment and to establish

partnerships in the field of commercial activities. To ensure that it retains its successful corporate culture, Probi offers personal development opportunities for both existing personnel and new recruits, and considerable emphasis is placed on performance reviews that provide feedback on the work performed, as well as on clear communication of the company's designated goals.

Focusing on patents

Anna Berggren is one of Probi's researchers. She is a graduate engineer and a Doctor of Engineering, and defended her doctoral thesis at Lund University's Department of Food Technology, Engineering and Nutrition at the Center for Chemistry and Chemical Engineering. She joined Probi in 1998.



Anna Berggren

"Probi operates in an extremely interesting area that includes both food research and biotechnology. In the seven years that I have been working at Probi, I have seen a clear increase in the interest expressed by external parties in learning about probiotic bacteria.

My work focuses mainly on the important patent applications that Probi submits to Swedish and international patent authorities, where we make ongoing contributions in the form of documentation and arguments that describe what Probi's bacteria are capable of doing. So my work also includes performing clinical studies of Probi's findings and conducting

establishing studies. Because the associated documentation is so important in conjunction with patent applications, it's clear to me that Probi enjoys a distinct advantage thanks to the fact that our important bacteria are both thoroughly documented and have a high survival rate."

Bacteria with a high survival rate

Karl Mohlin is responsible for Probi's bacteria production. He is a process engineer and has worked at Probi since the company was founded in 1991. Before joining Probi, he worked at the Department of Applied Microbiology at Lund University's Center for Chemistry and Chemical Engineering, and on a range of projects in cooperation with Probi's founders.



Karl Mohlin

"I have followed Probi and its research and development at close quarters for a number of years and have noticed the tremendous optimism surrounding the company, both internally and among our commercial partners.

My task is to develop new bacterial culture methods for strains that were developed as part of our research, and to mass-produce the bacteria on which Probi bases its research. This means that I cultivate bacteria that are then frozen before being supplied to our customers. In this production process, it's important for the probiotic bacteria to have a high survival rate, so as to ensure that their robust properties will be retained

Ethics and quality

in the end-product. The fact that our best-known bacterial strain, Lp299v, has these important properties has been an important factor in our success.”

Research that affects public health

Gunilla Önning is responsible for documenting the health effects of new foodstuffs that contain Probi's probiotics. She is a nutritional physiologist and an associate professor of biomedical nutrition at the Lund Institute of Technology who has now joined Probi.



Gunilla Önning

“The food industry's interest in probiotics with demonstrated effects on health has grown sharply in recent years. Probi's extensive network within both Swedish and foreign academic research groups has allowed us to boost our competitiveness among suppliers of probiotics for the growing functional food industry. The probiotic foods that we develop in cooperation with our partners are extensively and thoroughly documented.

Leaving the academic world to start work here has given me the chance to convert research into practical, consumer-oriented products. I'm doing something today that will have a direct future impact on public health.”

→ Ethics Committee approval

Probi follows the same high standards for clinical trials with regard to ethics as the pharmaceutical industry. This means that no clinical trials of Probi's bacteria are performed until an ethics committee has approved the trial's experimental plans. Approval of this kind secures the ethical aspect of Probi's trials with regard, for example, to target group, the substance to be tested, the tests to be carried out and the methods to be used.

Certification

Probi has, wherever possible, adhered to the same requirements as its customers – namely the food industry and the medical sector industry – with regard to quality assurance.

Probi has tailored its activities to the EU's new requirements, which came into force on 1st January 2005, whereby all foods must be traceable at all stages of the production, processing and distribution chain. Probi has also tailored its operations to the Hazard Analysis Critical Control Point (HACCP) monitoring programme – a quality assurance system for the entire production process that is expected to come into force within the EU in 2006. The HACCP programme specifies that the company must, among other things, determine and set threshold values for the critical points in the production process, and have an action programme to deal with any errors that may occur.

In 1998, Probi received its first quality certification from SWEDAC (the Swedish Board for Accreditation and Conformity Assessment). SWEDAC's representatives carry out annual inspections to ensure that quality requirements are being met, and an inspection on a larger scale is performed every fourth year prior to renewed accreditation. The most recent such inspection was performed at Probi in 2004. The accreditation means that Probi, in common with other accredited laboratories, gains international acceptance in 40 or so countries for its test reports and calibration certificates in accordance with the EN ISO/IEC 17025 standard.

Production quality

In addition to all the standard monitoring functions, Probi also performs extensive analyses of every new batch of the bacterial

cultures produced. Microbiologists ensure, among other things, that the bacterial content is correct and that hygiene maintains the highest possible standards. Identity analyses are also performed during which fermentation patterns and genetic profiles (Randomly Amplified Polymorphic DNA Analysis) are checked against the original culture. This process also includes tests of the bacterium's function.

Probi produces its bacteria in its cultivation facility at the Ideon Research Park in Lund. The production of fermented oat substrate takes place in our own factory in Sösdala outside Hässleholm. The production units are capable of handling a substantial increase in volume using existing capacity and can also, if necessary, quickly be scaled up without the need for significant investments. The production of dry products, such as dietary supplements, is partly outsourced to the external production units of quality-assured subcontractors.

The company's operational reliability is high. Probi has acquired the plant in Sösdala in order to secure long-term production capacity. Both production and deliveries have functioned extremely satisfactorily throughout the ten years that the Sösdala factory has been producing oat substrate for Skånemejerierna.

Security

Probi signs confidentiality agreements with both its personnel and external consultants, and the company strives to generate a high level of awareness with regard to sensitive information. Continuous supervision of systems, firewalls and virus protection provide protection against unauthorised access to Probi's IT network and data. Probi also works actively with operational reliability and monitors its security functions to ensure that they are managed efficiently and function smoothly. Backups are generated daily and are stored in fireproof cassettes in a locked, fire-certified document safe.

Environment

Probi's research and production have a negligible effect on the environment in that no harmful by-products are generated. The company's production unit in Sösdala is inspected regularly from environmental and health viewpoints by the municipal environmental authority.

Risk factors

→ Reliance on a few partners

Probi has only a few partners who are expected, within the foreseeable future, to provide the company with significant royalty revenues. If one or more of these partnerships were to be terminated or prove unsuccessful, it would have a significantly negative effect on Probi's revenue streams, results and financial position. At present, Skånemejerierna is the customer that accounts for the lion's share of the company's revenues.

Strategic research partnerships

Probi's research is based on both internal competence and external resources provided via Swedish and international researchers linked to Probi. The cooperation with these Swedish and foreign academic organisations has, to date, made a significant knowledge contribution to Probi's development work. There are no guarantees, however, that these partnerships will, in future, result in new discoveries, or that Probi will have the exclusive rights to any such discoveries.

Key individuals and employees

Probi's operations are heavily dependent on the competence of key individuals and specialists within the company. The company's potential for expansion is closely linked to Probi's ability to retain these employees and to attract new and highly qualified members of staff.

Probiotic regulation

The functional food market is at present under-regulated with regard to health claims. The introduction of regulations is however expected within the next few years, and these will apply equally to probiotics. These regulations are expected to boost demand for Probi's products, but they could also impose new routines on probiotic manufacturers that will increase the cost of their manufacturing processes.

Probiotics for the medical sector

Probi's focus on clinical nutrition presupposes a usage of probiotic nutritional solutions in the medical sector that does not currently exist. Probi believes that there is a medical need for probiotic products in the medical sector. Establishment of this usage could, however, take some time, and this would mean that the development expenses incurred by Probi would not be covered within the immediate future through commercial agreements.

Documentation and patent protection

Probi's commercial successes are largely dependent on its ability to protect patents and generate new research findings of the highest quality.

Future capital requirements

Probi's focus on biotechnology means that the company will always be burdened with substantial research and development expenses. These expenses are currently largely covered by commercial revenues. If opportunities for faster growth that entail a capital requirement arise, Probi may be forced to acquire additional capital by means of a new share issue, for example.

Financial risks

Probi's partnerships with international customers entail revenues in several different currencies, and these are affected by exchange rate fluctuations. The primary source of revenue at present is Skånemejerierna, and under the terms of the contract, these revenues are always paid in SEK, irrespective of whether they derive from royalties in the Nordic region or in the UK. A small percentage of revenues during 2004 were in EUR, but as and when the agreements with Danone and Institut Rosell generate royalty payments, the percentage of revenues in foreign currencies is expected to increase.

Probi has borrowed approximately SEK 4 million on the production facility in Sösdala at a variable interest rate. An increase of 1 per cent in the interest rate would mean an increase of approximately SEK 40,000 in interest expenses. The company has no interest-bearing operating liabilities.

Corporate governance

→ Openness and clarity

The Board of Directors and management of Probi strive to live up to the requirements of the company's shareholders and other stakeholders with regard to good corporate governance by means of openness, effective control and efficiently functioning routines.

Composition of the Board

Probi's Board of Directors is appointed annually at the Annual General Meeting. The current Board comprises six ordinary Members. The Chairman of the Board, Peter Zakrisson, is also a partner in Probi's second largest owner, H&B Capital, and Board Member Rolf Bjernedell is also the CEO of the biggest owner, Skånemejerierna. No Board Member is employed by the company. The company's CEO and the Controller and Head of Administration also attend the majority of Board Meetings, although they are not entitled to vote.

Remuneration to the Board of Directors and management

The Annual General Meeting determines the principles and threshold limits for directors' fees. A Member of the Board may, for a brief period of time, provide consulting services to Probi, but only after a Board resolution to this effect and only provided that it is deemed to be the most cost-effective and advantageous alternative for the company. Any such consulting fees are reported in the Annual Report.

Probi has taken out liability insurance cover for its Board Members and senior executives to cover the risk of personal liability during the performance of their duties on behalf of the company.

The working procedures of the Board of Directors

Each year, the Board of Directors draws up the rules of procedure that regulate the division of labour and responsibility between the Board, the Chairman and the CEO. The Board of Directors shoulders ultimate responsibility for Probi's organisation and the administration of the company's affairs. It makes decisions on significant organisational and operational changes and on the appointment and dismissal of the CEO.

The duties of the Board also include determining and evaluating strategies, business plans and budgets. The Board also adopts interim reports and preliminary financial statements.

It is incumbent upon the Chairman of the Board to monitor the company continuously and ensure that all Board Members receive the ongoing information required to assess and evaluate Probi. The Chairman of the Board shall also consult the CEO on strategic issues, act as the Chairman at Board Meetings, and ensure that the handling of items on the agenda of Board Meetings does not contravene the disqualification rules laid down in the Swedish Companies Act.

The Board shall draft a set of instructions for the CEO every year, containing guidelines on the ongoing management, bookkeeping and administration of funds, as well as internal checks and balances within the company. The instructions shall also include the extent of the CEO's authority and his or her obligation to supply the Board of Directors with information.

Pursuant to the Articles of Association, the Board of Directors shall hold at least five ordinary Meetings per year, over and above the statutory company meeting in conjunction with the Annual General Meeting. In 2004, the Board has paid particular attention to developments in connection with Probi's partnerships with Danone and Institut Rosell, market trends in relation to Clinical Nutrition, and the company's preparations for its listing on the O-list of the Stockholm Stock Exchange.

Audit Committee

Probi's Audit Committee comprises the Board of Directors. The Board maintains continuous contact with the auditors, who present their audit reports and observations twice a year in person. At these meetings, the auditors also provide details of the areas that are due to be specifically addressed by the next audit and the Board also provides the auditors with answers to questions or details of areas to which the Board wishes particular attention to be paid.

Remuneration and Nomination Committees

Probi's Remuneration Committee comprises the Board of Directors. The Chairman of the Board drafts a proposal relating to directors' fees ahead of the statutory company meeting. The proposal is checked and approved by the Nomination Committee. The Remuneration Committee also determines salaries and remuneration payable to the CEO and other senior executives of Probi, and monitors conditions of employment on an ongoing basis – see Note 7 to the Accounts.

The Annual General Meeting elects the Nomination Committee, which shall comprise representatives of the two biggest owners and one representative of the other owners. The Committee currently comprises Lars Gatenbeck (H&B Capital), Jan Persson (Skånemejerierna) and Carl Henrik Shah.

The Chairman of the Board and the Nomination Committee present a proposal for a new Committee for the period up to and including the next Meeting. A representative of the biggest owner shall convene the Nomination Committee well in advance of the Annual General Meeting, in order to submit proposals to the Meeting concerning the ordinary Board Members, any Deputy Members and the auditors. Their recommendation shall also be submitted to the Board of Directors in January/February.

The Directors' Report

→ The Board of Directors and the CEO of Probi Aktiebolag (publ), company reg. no. 556417-7540, hereby present the Annual Accounts and the Consolidated Accounts for 2004.

Probi is a biotechnology company with a leading position in the field of probiotics. The company conducts its own research and development in the following fields: Gastrointestinal complaints, Immunology, Risk factors for cardiovascular disease and Stress and performance recovery.

Probi's research has demonstrated positive medical effects in all of the company's research fields, and the company owns a total of 93 patents in 10 patent fields. Probi's income model entails the receipt of license fees for market exclusivity, and of royalty payments for the use of Probi's patented and documented bacterial strains based on ongoing market sales.

The two wholly owned subsidiary companies are dormant and the operations of the Parent Company are thus the same as those of the Group.

OPERATIONS IN 2004

The Board of Directors decided during the year to apply for listing on the Stockholm Stock Exchange's O-list and to effect a new share issue with the aim of consolidating Probi's position as a supplier of documented probiotics. The proceeds of the issue will be used to finance and accelerate the development and commercialisation of product concepts, primarily for Clinical Nutrition.

The Extraordinary General Meeting of Shareholders held in the autumn resolved to introduce a single class of share and to amalgamate shares by combining five old shares to form one new one. Major shareholders also sold shares in conjunction with the new share issue in order to increase the ownership diversity and generate the right conditions for better liquidity in the company's shares.

The offering comprised a total of 1,714,200 shares, of which 1,142,800 comprised newly issued shares and 571,400 comprised existing shares. This corresponds to approximately 18 per cent of the total number of shares and votes in the company after the new share issue. The new issue entails a dilution effect of 12.2 per cent. The offering was oversubscribed and generated a net capital contribution for Probi of SEK 32.0 million. Probi's shares were quoted on the O-list of the Stockholm Stock Exchange on 2nd December 2004.

Functional Food

The market for probiotic foods has continued to grow during the year. The increased interest focuses primarily on the field of thoroughly documented probiotics and arises from new scientific findings, as well as from increased awareness among consumers of the positive health-giving effects of probiotics.

Probi's partner, Skånemejerierna, has enjoyed a continued healthy sales performance during the year with its ProViva brand name, which contains Probi's Lp299v bacteria. Probi's total royalty income from Skånemejerierna increased during the year by 8 per cent (17 per cent).

Five-year overview

SEK thousand		2004	2003	2002	2001	2000
Summary of the Income Statement						
Net turnover		31,619	27,462	26,063	18,992	17,581
Total operating income		31,915	27,470	27,257	20,697	18,118
Total operating expenses		-39,694	-35,998	-39,768	-34,654	-33,502
Operating result		-7,779	-8,528	-12,511	-13,957	-15,383
Result after financial items		-7,366	-8,180	-14,128	-11,925	-13,827
Net result for the year		-7,366	-8,180	-14,128	-11,925	-13,790
Key figures						
	Definition	2004	2003	2002	2001	2000
Equity/assets ratio	1	89.9%	80.8%	88.3%	73.1%	96.1%
Debt/equity ratio	2	4.5%	6.7%	6.2%	5.0%	0%
Return on capital employed	3	-9.6%	-12.0%	-14.6%	-13.3%	-22.9%
Return on equity	4	-10.4%	-13.1%	-19.2%	-13.8%	-22.9%
Cash liquidity	5	903%	247%	487%	205%	2,158%
Average number of employees		17	15	17	16	15
Value added/employee, SEK thousand	6	383	455	-18	-223	-526

1. Shareholders' equity as a percentage of balance sheet total.
2. Interest-bearing liabilities as a percentage of shareholders' equity.
3. Operating result plus income as a percentage of balance sheet total less non-interest-bearing liabilities and provisions.
4. Pre-tax profit as a percentage of average shareholders' equity.
5. Total current assets, excluding stock in trade, as a percentage of current liabilities.
6. Operating result plus payroll expenses and payroll overheads per employee.

Ever since 2003, Probi has had a licensing agreement with Danone, the world's biggest supplier of chilled dairy products and Europe's dominant supplier of probiotic products. Development work on a new product concept containing Probi's Lp299v bacterium has continued during the year. The project has made substantial progress and Danone has developed product solutions during the reporting period. The project is now in a phase where a marketing concept is being developed and a launch is being planned, although Danone has not yet announced a launch date.

Dietary supplements

Today's probiotic dietary supplements primarily comprise dry products, such as tablets, sachets and capsules, and the market for probiotic dietary supplements is fragmented, both geographically and in terms of players.

The past year has seen Probi's partner, Institut Rosell, develop capsules with a long shelf life at room temperature that contain Probi's Lp299v probiotic. Probi has conducted a clinical trial and has thereby successfully verified the product's quality. In December, Institut Rosell signed its first distribution agreement for this product, whereby Phillips Health was granted exclusive rights to market the product directly by mail order in the USA. The product was launched at the beginning of the year. Institut Rosell is continuing to work on launches via additional sales channels and in other markets.

Probi's partner, Health World, launched a new dietary supplement in the form of capsules containing the Lp299v bacterium during the year. The product was launched in September and its primary distribution channel is composed of Australia's 6,000 or so pharmacies and health food shops.

Clinical Nutrition

Probi has expanded its research and development with regard to a variety of probiotic product concepts for use in the medical sector during the year. Probi now has a product concept in the late phase of development, which can, with minimal investment, be adapted to produce a marketable product. Suitable partners operating in the medical sector have been contacted during the period and Probi is currently engaged in discussions with several of them.

Research and development

Probi has documented important mechanisms of action and properties of its patented *Lactobacillus plantarum* 299v bacterium during the year. These research findings have resulted, among other things, in Probi applying for a patent for a new functional area that may find a market within Functional Food. The aim of the patent is to consolidate Probi's position in Functional Food still further. The company will be able to offer new product concepts in this sphere as of 2005. Probi's patent applications also include new bacterial strains that have

demonstrated interesting properties and offer new opportunities in all of the company's business areas.

A study that attracted considerable attention was presented during the year at the Biotech Forum meeting in Copenhagen. The work describes new findings with regard to Probi's Lp299v bacterium in combination with fruit extracts. At the year's biggest European clinical nutrition congress, ESPEN, Probi also presented a meta-analysis of clinical studies carried out on 230 seriously ill patients. The results confirm the fact that Probi's first product in the Clinical Nutrition sphere constitutes a valuable addition to the arsenal used to reduce the number of infections in conjunction with intensive care treatment. When Probi's probiotic was given to these patients, only 10 per cent of them developed infections, in comparison with 39 per cent in conjunction with conventional therapy.

Other research work has involved documenting tests on new bacterial strains and product concepts. These have included immunological studies on humans in which some interesting effects of different bacteria on the body's immune system have been charted.

During the year, Probi has also provided Danone with research-related assistance in connection with product development and research documentation for the new product containing Probi's probiotic.

Probi is participating in a new EU project approved by the European Commission in 2004. The primary focus of this project is the development of a formulation technology particularly suited to probiotics.

PERSONNEL

Probi had 17 employees at the end of the year, 9 of whom are women and 8 of whom are men. The average number of employees during the year was 17 (15). The company now employs 7 researchers who have defended their doctoral theses.

TURNOVER AND RESULTS

Operating income during the year totalled SEK 31.9 million (SEK 27.5 m), an increase of 16 per cent. Probi's result after tax for the year as a whole was SEK -7.4 million (SEK -8.2 m). Income has increased by SEK 4.4 million on last year, and operating expenses have increased by SEK 3.7 million. Total costs for the company's O-listing during the year have increased other external costs by SEK 3.0 million.

The Functional Food business area reported a positive operating result for 2004 of SEK 5.1 million, while the Dietary Supplements business area reported a negative operating result of SEK -1.2 million, due to the fact that Institut Rosell launched the first product containing Probi's probiotic bacteria at the turn of the year. The Clinical Nutrition business area has not as yet issued any invoices, and the operating expenses are therefore the same as the operating result, namely SEK -5.8 million.

CASHFLOW AND FINANCIAL POSITION

Probi's cashflow during the year, including the new share issue, was SEK 26.8 million (SEK 0.8 m). Cashflow from operating activities totalled SEK -3.8 million (SEK 3.4 m). Liquid assets at the end of the year totalled SEK 46.9 million (SEK 20.1 m). The new share issue implemented during the year generated SEK 37.1 million for the company. Issue costs totalled SEK 5.1 million, and the new share issue has thus made a net contribution to liquidity of SEK 32.0 million.

Probi invests significant amounts in research, and the company has therefore reported a loss. R&D expenses, excluding raw materials and consumables, comprised 46.3 per cent (48.4 per cent) of total costs during the reporting period in question.

The company's accumulated fiscal loss on 31st December 2004 is SEK 57.8 million. The accumulated loss includes a deferred tax receivable of SEK 16.2 million, which can be utilised in future once the company starts reporting a profit. The company has valued this deferred tax receivable at zero.

There are no undertakings in respect of former Board Members or senior executives. The company was not involved in any legal proceedings in 2004.

EVENTS AFTER THE CLOSING DATE

No significant events have occurred after the closing date.

FUTURE DEVELOPMENT

Probi's business model is based on conducting research and development, patenting and documenting probiotic bacteria and product concepts, and producing probiotic bacteria. Probi offers licences to companies that produce, distribute and market products based on Probi's patented bacteria and product concepts. The company will continue to operate according to its stated plan.

ENVIRONMENTAL IMPACT

The Group is not engaged in any operations for which a permit is required pursuant to the Swedish Environmental Code.

SUBSIDIARIES

Probi AB has two wholly owned subsidiaries, Probi Food AB and Probi Feed AB. Both companies are dormant.

THE BOARD OF DIRECTORS AND THEIR RULES OF PROCEDURE

Probi AB's Board of Directors comprises six ordinary Members, who are elected by the Annual General Meeting. Peter Zakrisson is the Chairman of the Board. The Board has held 13 meetings during 2004. The Board has adopted rules of procedure that include an annual reporting plan and an instruction regarding the division of labour between the Board of Directors and the CEO. The Board of Directors has played an active part in pursuing the company's strategies and goals and has also been involved during the year in the work entailed by the new share issue and the listing on the Stockholm Stock Exchange.

Every year, the company's principal auditor reports in person to the Board on his observations made in the course of the audit, as well as his assessment of the company's internal monitoring procedures. The Annual General Meeting has appointed a Nomination Committee that represents both small

and large shareholders and is tasked with submitting proposals with regard to the election of Board Members.

Matters for the Audit Committee and the Remuneration Committee are handled separately by the Board of Directors in its entirety.

OWNERSHIP STRUCTURE

According to VPC AB (the Swedish Central Securities Depository), Probi had 5,297 shareholders (4,859) on 30th December 2004. The company is listed on the O-list of the Stockholm Stock Exchange. An incentive programme comprising 428,000 warrants for personnel and the Board of Directors was terminated during the year without subscription for any new shares. The company currently has no outstanding conversion loans or outstanding warrants.

TRANSITION TO IFRS

Probi will, as of 1st January 2005, be compiling its financial reports in accordance with IFRS. The transition to IFRS is reported in accordance with IFRS 1, "First-time adoption of International Financial Reporting Standards", the transition date being 1st January 2004. IFRS 1 states that the comparative year of 2004 shall also be reported in accordance with IFRS. No adjustment will be made for financial years before 2004 – an approach that complies with the transitional rules laid down in IFRS 1.

Swedish accounting praxis has gradually shifted closer to the rules laid down in IFRS, but the transition to reporting in accordance with IFRS will still entail certain changes. The following section describes the areas considered likely to have a significant effect on Probi's shareholders' equity and Income Statement for 2004. This description has been compiled in accordance with the principles scheduled for implementation on 31st December 2005. IFRS is subject to ongoing review and approval by the EU, and changes may consequently still be made. The following information may therefore be affected by such changes.

As far as Probi is concerned, the most significant changes entail adaptations in line with IFRS 3, "Business combinations", which requires that goodwill and other intangible assets with an undetermined useful life no longer be amortised but tested instead to determine any write-down requirement. The transition to IFRS will thus result in the reversal of the goodwill amortisation effected in accordance with Swedish accounting principles in 2004. These reversals total SEK 0.7 million.

Probi has not identified any adjustments with regard to the opening balance on 1st January 2004. Apart from goodwill amortisation, no other adjustments that will affect the result for 2004 have been identified.

The introduction of IAS 39, Financial Instruments, as of 2005, has no effect on shareholders' equity.

PROPOSED ALLOCATION OF LOSS

The Board of Directors and the CEO propose that the Parent Company's accumulated loss of SEK -5,925 thousand, of which the loss for the year comprises SEK -6,675 thousand, be offset in its entirety against the share premium reserve. According to the Balance Sheet, the Group's accumulated loss totals SEK -5,573 thousand. No allocations to restricted reserves are required.

Income Statement

SEK thousand	Note	The Group		The Parent Company	
		2004	2003	2004	2003
Operating income	1				
Net turnover	4	31,619	27,462	31,619	27,462
Change in stock in trade		78	-318	78	-318
Other operating income		218	326	218	326
Total operating income	3,21	31,915	27,470	31,915	27,470
Operating expenses					
Raw materials and consumables		-956	-585	-956	-585
Other external costs	5,6	-17,494	-13,187	-17,494	-13,187
Staff overheads	6,7	-14,298	-15,348	-14,298	-15,348
Depreciation of fixed assets	9	-6,946	-6,878	-6,255	-6,187
Total operating expenses	21	-39,694	-35,998	-39,003	-35,307
Operating result		-7,779	-8,528	-7,088	-7,837
Result from financial investments					
Interest income		577	562	577	562
Interest expenses		-164	-214	-164	-214
Total result from financial investments		413	348	413	348
Result after financial items		-7,366	-8,180	-6,675	-7,489
Tax on the result for the year		0	0	0	0
Net result for the year		-7,366	-8,180	-6,675	-7,489
No. shares at year-end		9,365,300	41,112,500		
EPS before and after dilution, SEK		-0.79	-0.20		
EPS adjusted for amalgamation, SEK		-0.79	-0.99		

Cashflow Analysis

SEK thousand	The Group		The Parent Company	
	2004	2003	2004	2003
Operating activities				
Operating result	-7,779	-8,528	-7,088	-7,837
Depreciation, amortisation and write-downs	6,946	6,878	6,255	6,187
Interest received	577	562	577	562
Interest paid	-164	-214	-164	-214
Cashflow from operating activities before changes in operating capital		-1,302	-420	-1,302
Change in stock in trade	-78	319	-78	319
Change in operating receivables	1,042	-731	1,042	-731
Change in operating liabilities	-4,393	5,140	-4,393	5,140
Cashflow from operating activities	-3,849	3,426	-3,849	3,426
Investment activities				
Acquisition of intangible fixed assets	-792	-1,658	-792	-1,658
Acquisition of tangible fixed assets	-1,145	-936	-1,145	-936
Cashflow from investment activities	-1,937	-2,594	-1,937	-2,594
Financing activities				
Amortisation	-137	-46	-137	-46
VAT reversed	750	0	750	0
New share issue	31,984	0	31,984	0
Cashflow from financing activities	32,597	-46	32,597	-46
Change in liquid assets	26,811	786	26,811	786
Opening liquid assets	20,113	19,327	20,113	19,327
Closing liquid assets	46,924	20,113	46,924	20,113

Balance Sheet

SEK thousand	Note	The Group		The Parent Company	
		2004	2003	2004	2003
ASSETS	2,3				
Fixed assets					
Intangible fixed assets					
Patents, licenses and similar rights	11	29,898	33,640	29,898	33,640
Goodwill	12	2,071	2,762	0	0
		31,969	36,402	29,898	33,640
Tangible fixed assets					
Buildings and land	13	4,117	4,278	4,117	4,278
Inventories, tools and installations	14	5,192	5,607	5,192	5,607
		9,309	9,885	9,309	9,885
Financial fixed assets					
Participations in Group companies	15	0	0	4,031	4,031
Total fixed assets		41,278	46,287	43,238	47,556
Current assets					
Stock in trade etc.					
Finished goods		1,384	1,306	1,384	1,306
Total stock in trade		1,384	1,306	1,384	1,306
Current receivables					
Accounts receivable		2,528	3,585	2,528	3,585
Prepaid costs and accrued income	16	956	941	956	941
Total current receivables		3,484	4,526	3,484	4,526
Cash and bank		46,924	20,113	46,924	20,113
Total current assets		51,792	25,945	51,792	25,945
Total assets		93,070	72,232	95,030	73,501

Balance Sheet

SEK thousand	Note	The Group		The Parent Company	
SHAREHOLDERS' EQUITY & LIABILITIES	2	2004	2003	2004	2003
Shareholders' equity	17				
Restricted shareholders' equity					
Share capital		46,827	41,113	46,827	41,113
Restricted reserves		42,455	20,569	40,672	21,891
Statutory reserve		0	0	60	60
Total restricted shareholders' equity		89,282	61,682	87,559	63,064
Non-restricted shareholders' equity/loss brought forward					
Non-restricted reserves/loss brought forward		1,793	4,839	750	0
Net result for the year		-7,366	-8,180	-6,675	-7,489
Total non-restricted shareholders' equity/loss brought forward		-5,573	-3,341	-5,925	-7,489
Total shareholders' equity		83,709	58,341	81,634	55,575
Long-term liabilities					
Other long-term liabilities	18	3,781	3,918	3,781	3,918
Liabilities to Group companies		0	0	4,035	4,035
Total long-term liabilities		3,781	3,918	7,816	7,953
Current liabilities					
Current part of long-term liability		137	137	137	137
Accounts payable		1,953	851	1,953	851
Tax liabilities		73	42	73	42
Other liabilities		429	1,233	429	1,233
Accrued costs and prepaid income	19	2,988	7,710	2,988	7,710
Total current liabilities		5,580	9,973	5,580	9,973
Total shareholders' equity & liabilities		93,070	72,232	95,030	73,501
Pledged assets	20	4,100	4,100	4,100	4,100
Contingent liabilities		None	None	None	None

Changes in shareholders' equity, Group	Share capital	Restricted reserves	Non-restricted equity	Total shareholders' equity
Opening balance, 1st Jan. 2003	41,113	34,697	-9,289	66,521
Transfer between non-restricted and restricted equity		-14,128	14,128	0
Net result for the year			-8,180	-8,180
Opening balance, 1st Jan. 2004	41,113	20,569	-3,341	58,341
New share issue	5,714	31,427		37,141
New share issue costs		-5,157		-5,157
VAT reversed			750	750
Transfer between non-restricted and restricted equity		-4,384	4,384	0
Net result for the year			-7,366	-7,366
Shareholders' equity, 31st Dec. 2004	46,827	42,455	-5,573	83,709
Changes in shareholders' equity, Parent Company	Share capital	Restricted reserves	Non-restricted equity	Total shareholders' equity
Opening balance, 1st Jan. 2003	41,113	35,388	-13,437	63,064
Allocation of previous year's result		-13,437	13,437	0
Net result for the year			-7,489	-7,489
Opening balance, 1st Jan. 2004	41,113	21,951	-7,489	55,575
New share issue	5,714	31,427		37,141
New share issue costs		-5,157		-5,157
VAT reversed			750	750
Allocation of previous year's result		-7,489	7,489	0
Net result for the year			-6,675	-6,675
Shareholders' equity, 31st Dec. 2004	46,827	40,732	-5,925	81,634

Notes to the Accounts

→ All amounts are in SEK thousand unless otherwise stated.

Accounting and valuation principles

The accounting and valuation principles applied comply with the provisions of the Swedish Annual Reports Act and the recommendations of the Swedish Financial Accounting Standards Council.

Probi applies the following Swedish Financial Accounting Standards Council recommendations as of 2004: recommendation RR 25, Segment reporting – lines of business and geographic markets, and recommendation RR29, Remuneration to employees. Neither of these recommendations has affected the company's result or financial position on 1st January 2004.

Consolidated accounts

The consolidated annual accounts comprise the annual accounts for the Parent Company and all subsidiaries, as defined in the Swedish Annual Reports Act.

All companies in which the Group holds or controls more than 50 per cent of the votes or in which the Group contractually exercises an exclusive determining influence are consolidated as subsidiaries. Subsidiaries are consolidated as of and including the day on which the Group gains control of the company, and sold subsidiaries are included in the consolidated accounts up to and including the day on which the Group retains control over the company.

The consolidated accounts are compiled using the acquisition method. Shareholders' equity in subsidiaries acquired is calculated on the basis of a market valuation of assets and liabilities at the time of acquisition (known as an acquisition analysis). If the market valuation of assets and liabilities yields values that differ from those of the acquired Group's book values, these market values constitute the Group's acquisition value.

If the acquisition value for the subsidiary's shares exceeds the estimated value of the net assets at the time of acquisition, the difference is reported as consolidated goodwill. If the acquisition value is less than the value of the net assets, the difference is reported as consolidated negative goodwill.

If necessary, an allocation is made to reserves in conjunction with the acquisition analysis for future costs arising from reorganisation and staff cuts in the acquired companies, in accordance with the rules laid down for allocations in recommendation RR 16 of the Swedish Financial Accounting Standards Council.

The effects of all intra-Group transactions, such as income, expenses, receivables and liabilities, together with unrealised results and Group contributions, have been eliminated.

Income

Sales of goods are reported in conjunction with delivery of the product, which corresponds to the time at which the risk is transferred to the customer. Royalty revenues are reported on the basis of the reporting by partners of distributor sales. Initial licensing revenues (down payments in conjunction with the signing of the contract) are periodised over the period until the date when Probi expects a launch to occur in a territory and the income streams change from distributor sales to royalty revenues.

Interest income is reported in accordance with effective yield.

Segment classification

Lines of business comprise products or services that are subject to risks and returns that differ from those of other lines of business. Geographic markets supply products or services within a distinct economic environment that is subject to risks and returns that differ from the risks and returns that apply to units operating in other economic environments. Lines of business are classified as primary segments in the Group and the Parent Company, while geographic areas are classified as secondary segments.

Pensions

As of 1st January 2004, Probi applies recommendation RR 29, Remuneration to employees, issued by the Swedish Financial Accounting Standards Council. This recommendation defines plans for remuneration once employment is terminated as either defined benefit plans or defined contribution plans. In defined contribution plans, the company's legal or informal obligation is limited to the contribution amount that the company agrees to pay. The Group's payments in respect of defined contribution plans are reported as a cost during the period in which the employee has carried out the services to which the contribution refers. All plans not classified as defined contribution plans are considered defined benefit plans. Defined benefit plans shall be booked in the Balance Sheet and calculated

in accordance with the actuarial method specified in the recommendation. All of the Company's pension plans are defined contribution plans.

Provisions

Provisions are reported when the Group has, or may be deemed to have, an undertaking as a result of events that have occurred and it is likely that payments will be required in order to fulfil the undertaking. The ability to make a reliable estimate of the amount to be disbursed is a further prerequisite.

Provision is made for any restructuring measures when a detailed formal plan has been drawn up for the measures and well-founded expectations have been created in those who will be affected by these measures.

Leasing

Leasing agreements are classified within the Group as either financial leasing or operational leasing.

Leasing agreements in respect of fixed assets where the Group in every significant respect bears the same risks and enjoys the same benefits as with direct ownership are classified as financial leasing.

Operational leasing agreements: Leasing of fixed assets where the lessor in every significant respect remains the owner of the asset is classified as operational leasing. The leasing charge for operational leasing is booked as a cost linearly over the leasing period.

Financial leasing agreements: When leasing agreements mean that the Group, as the lessee, in every significant respect enjoys the economic benefits and bears the economic risks associated with the leasing object, the object is reported as a fixed asset in the Consolidated Balance Sheet. Corresponding undertakings to pay leasing charges in the future are reported as liabilities. In the Parent Company, all leasing agreements, irrespective of whether they are financial or operational, are reported as rental agreements (operational leasing agreements).

All leasing contracts in the company are of an operational nature.

Loan costs

Loan costs are taken up as income in the period to which they refer, irrespective of the use to which the borrowed funds have been put. Interest is not booked as an asset in the acquisition value of assets.

Income tax

Income taxes reported comprise tax payable or receivable in respect of the year in question, together with adjustments made in respect of actual tax for previous years. Valuation of all tax liabilities/receivables is effected at nominal amounts and in accordance with the tax regulations and tax rates instituted or announced and likely to be confirmed.

Associated tax effects are also reported in the Income Statement for items reported therein. Tax effects of items booked directly to shareholders' equity are reported against shareholders' equity.

Deferred tax is calculated using the Balance Sheet method on all temporary differences arising between reported and fiscal values of assets and liabilities. Deferred tax receivables in respect of deficit deductions or other future fiscal deductions are reported to the extent that it is likely that the deduction can be offset against surpluses in conjunction with future taxation. Deferred tax receivables attributable to fiscal loss deductions have not been reported pending product launches arising from new agreements.

Intangible assets

Goodwill: Goodwill comprises the amount by which the acquisition value exceeds the true value of the Group's participation in the acquired subsidiary's net assets at the time of the acquisition. Goodwill is amortised linearly over the estimated useful life. Goodwill is amortised over 10 years when it has arisen in conjunction with strategic acquisitions.

Accounting principles in respect of research and development expenses: Research expenses are booked as expenses on a rolling basis. Development expenses are reported as assets from the date when it is deemed that the project or activity to which they relate will lead to a technically and commercially launchable product and where Probi has decided to seek a partner or in some other way attempt to launch the product. The company conducts research and development work in the probiotics field. Probi's licensees use this probiotic in their own products and these are in turn further developed for launch and commercial use. Probi provides assistance, but is not the party that completes the development of the end-product.

Probi may, in certain cases, develop a product solution with the intention of presenting a potential licensee with an opportunity in new areas. Probi does not however control the launch or the choice of product solution. Probi has thus not been able to present a reasonable claim to the effect that all of the circumstances required in accordance with the Swedish Financial Accounting Standards Council's recommendation RR 15 with regard to the capitalising of development expenses obtain. Development projects with regard to existing launches involving Probi's probiotics will probably meet the requirements for capitalising development expenses.

Other intangible assets: Patent and licensing expenses are carried forward and amortised linearly over their contractually regulated useful life. The following amortisation periods are applied:

- Patents – 5 years
- Licences – 12 years

Write-downs of intangible assets: When there is an indication that the value of an asset has declined, an assessment is made of the asset's reported value, including goodwill. If the reported value of an asset exceeds its estimated recovery value, the asset is immediately written down to its recovery value.

Tangible fixed assets

Tangible fixed assets are reported at the acquisition value less depreciation. Expenses incurred in conjunction with improvements to the performance of assets over and above the original level increase the reported value of the assets. Expenses incurred in conjunction with repairs and maintenance are reported as costs.

Tangible fixed assets are depreciated systematically over the estimated useful life of the asset. Linear depreciation methods are used for all types of tangible asset. The following depreciation periods are applied:

- Buildings – 25 years
- Inventories, tools and installations – 3–10 years

Write-downs of tangible assets: When there is an indication that the value of an asset has declined, an assessment is made of the asset's reported value, including goodwill. If the reported value of an asset exceeds its estimated recovery value, the asset is immediately written down to its recovery value.

Financial instruments

Financial instruments reported in the Balance Sheet include liquid assets, (securities), financial receivables, accounts receivable and accounts payable, together with loan liabilities.

Securities: Securities intended for long-term holding are reported at their acquisition value and write-downs are effected if a lasting fall in value is confirmed.

All transactions in securities are reported on the settlement date.

Borrowing: Financial liabilities are initially reported in the amount received, net after deductions for transaction costs. If this figure differs from the amount to be repaid on the due date, the difference is periodised over the duration of the loan.

All transactions are reported on the settlement date.

Derivatives: The majority of the Group's income comprises royalties and licences, and the royalty level is regulated and fixed in the respective contracts. The basis for the royalty is the distribution price of the end-product, and a change in the distribution price can therefore affect the Group's income.

When the Group utilises derivatives, hedging is used to cover the risk of exchange rate fluctuations and to secure the Group's exposure to interest risks.

Currency futures protect the Group against fluctuations in exchange rates by setting the rate at which an asset or liability in a foreign currency will be realised. An increase or decrease in the amount required for the settlement of the asset/liability is compensated for by a corresponding change in the value of the futures contract. These profits and losses are therefore offset and are not included in the financial reports. Futures premiums/discounts are periodised over the duration of the contract as interest.

When interest swap agreements are used, this is done to protect the Group against changes in interest rates. Any interest rate difference to be obtained or paid due to an interest swap is reported as interest income or interest expenses, periodised over the duration of the agreement. Profits or losses when a futures contract is terminated, or when loans are repaid in advance, are taken up as income on an ongoing basis. Interest instruments that do not fulfil the criteria for hedging reporting are valued in conjunction with the closing day, at which point provision is made for unrealised losses.

Hedging reporting requires the explicit purpose of the hedging measures to be hedging. It also requires these measures to have an unambiguous link to the hedged item, and the hedging must also provide effective protection for the hedged position. Other derivatives are reported using the lower of cost or market principle.

Stock in trade

Stock in trade is valued, using the FIFO principle, at whichever is the lower of the acquisition value and the net sales value on the closing day.

Accounts receivable

Accounts receivable are reported in the amount likely to be received, based on an individual assessment of doubtful accounts receivable.

Foreign currencies

Assets and liabilities in foreign currencies are valued at the closing day rate. Where currency hedging measures have been implemented, e.g. futures hedging, the futures rate is used. Transactions in foreign currencies are recalculated at the call rate on the transaction date.

Hedging instruments are not recalculated in conjunction with currency hedging of future budgeted flows in the event of exchange rate fluctuations. The entire effect of fluctuations in exchange rates is reported in the Income Statement when the hedging instruments fall due for payment.

Cashflow Analysis

The Cashflow Analysis is compiled using the indirect method. The reported cashflow only comprises transactions that entail payments being received or made. Bank deposits and petty cash are defined as liquid assets.

Note 1. Income Statement per line of business

The Group operates primarily within three business areas: Functional Food ("FF"), Dietary Supplements ("DS") and Clinical Nutrition ("CN").

The FF business area has been secure since the first licensing agreement was signed in 1993. DS became an independent business area in 2002. The company launched CN as an independent business area in 2003.

The category "Other" comprises unallocated research and commercial development expenses, terminated operations, general administrative costs, headquarters-related costs, other central costs and financial items.

Severance pay disbursed to a former CEO is reported under "Other" for 2003. No sales or other transactions occur between the various lines of business.

Income Statement per line of business

The Group	2004					2003				
	FF	DS	CN	Other	Total	FF	DS	CN	Other	Total
Total operating income	29,551	2,146	0	218	31,915	26,376	208	0	886	27,470
Total operating expenses	-24,422	-3,360	-5,769	-6,143	-39,694	-24,307	-2,169	-2,144	-7,378	-35,998
Operating result	5,129	-1,214	-5,769	-5,925	-7,779	2,069	-1,961	-2,144	-6,492	-8,528

Notes

Note 2. Balance Sheet per line of business

The category "Other" comprises assets and liabilities attributable to joint research and business development activities, terminated operations, Group-wide activities and items of a financial nature. The assets of the lines of business principally comprise intangible assets, tangible fixed assets, stock in trade and receivables.

The liabilities of the lines of business comprise purchases of tangible fixed assets and intangible assets.

Balance Sheet per line of business

The Group	2004					2003				
	FF	DS	CN	Other	Total	FF	DS	CN	Other	Total
Total assets	40,615	951	2,068	49,436	93,070	48,201	877	731	22,424	72,232
Long-term liabilities	0	0	0	3,781	3,781	0	0	0	3,918	3,918
Current liabilities	2,416	489	106	2,569	5,580	7,756	445	51	1,721	9,973
Total liabilities	2,416	489	106	6,350	9,361	7,756	445	51	5,639	13,891
Shareholders' equity	0	0	0	0	83,709	0	0	0	0	58,341
Investments	958	0	979	0	1,937	2,075	241	278	0	2,594
Depreciation, amortisation and write-downs	-5,929	-251	-528	-238	-6,946	-6,079	-262	-228	-309	-6,878

Note 3. Operating income, assets and investments broken down by geographic market

The operations' income, assets and investments break down as follows by geographic market:

The Group	2004				2003			
	Nordic region	Europe other	Global other	Total	Nordic region	Europe other	Global other	Total
Operating income	20,723	9,046	2,146	31,915	20,099	7,163	208	27,470
Assets	63,002	29,636	432	93,070	39,126	33,040	66	72,232
Investments	933	885	119	1,937	1,682	663	249	2,594

The Parent Company	2004				2003			
	Nordic region	Europe other	Global other	Total	Nordic region	Europe other	Global other	Total
Operating income	20,723	9,046	2,146	31,915	20,099	7,163	208	27,470
Assets	64,962	29,636	432	95,030	40,395	33,040	66	73,501
Investments	933	885	119	1,937	1,682	663	249	2,594

Note 4. Breakdown of net turnover

Net turnover includes income from:

	The Group		The Parent Company	
	2004	2003	2004	2003
Goods	1,667	1,267	1,667	1,267
Royalties, licenses etc.	29,952	26,195	29,952	26,195
Total	31,619	27,462	31,619	27,462

Note 5. Auditors' fees

	The Group		The Parent Company	
	2004	2003	2004	2003
Audits	249	200	249	200
Commissions other than the audit	673	23	673	23
Total	922	223	922	223

Note 6. Research and development

	The Group		The Parent Company	
	2004	2003	2004	2003
Research and development expenses booked as costs	14,692	13,802	14,692	13,802

Note 7. Average number of employees, salaries, other remuneration and payroll overheads

	The Group		The Parent Company	
	2004	2003	2004	2003
Average number of employees	17	15	17	15
Women	9	7	9	7
Men	8	8	8	8
Total	17	15	17	15

Salaries and remuneration

	2004	2003	2004	2003
The Board of Directors and CEO	2,112	1,658	2,112	1,658
Other management	2,673	2,327	2,673	2,327
Severance pay to former CEO	-	2,269	-	2,269
Other employees	4,386	3,805	4,386	3,805
Total	9,171	10,059	9,171	10,059

Note 7. Average number of employees, salaries, other remuneration and payroll overheads

Payroll overheads, total	4,645	5,005	4,645	5,005
Of which pension costs for the Board and CEO	358	375	358	375
Of which pension costs for other management personnel	597	637	597	637
Of which pension costs for other employees	352	305	352	305
Salary and pension premiums for the CEO:	The Group		The Parent Company	
	2004	2003	2004	2003
Salary	1,587	1,011	1,587	1,011
Pension premiums	358	375	358	375

Salary payments made to the CEO of the Company in 2004 totalled SEK 1,587 thousand, of which SEK 330 thousand comprised a bonus. The Company has also paid SEK 358 thousand in pension premiums for the CEO. There is currently no bonus programme for the CEO and other senior executives. The period of notice for the CEO is six months if notice is given by the CEO and twelve months if notice is given by the Company. Severance pay shall also be payable in the sum of twelve months' salary when notice is given by the Company. The period of notice for other senior executives is six months if notice is given by Probi and three months if notice is given by the employee. The CEO's salary is set by the Board of Directors and those of the rest of the management by the CEO and the Chairman of the Board.

On 31st December 2003, Probi had warrants issued from a 2001/2004 programme. The warrants programme expired on 31st May 2004 with no shares subscribed.

The principal owners have issued 40,000 and 20,000 stock options at the market price to the CEO and a member of the management group respectively. The stock options entitle the holders to acquire shares at a price of SEK 44 during the period from 1st January 2007 to 31st August 2007.

The Company has no outstanding and unreported pension undertakings in that all pensions are premium-based. There is no share-based remuneration in the Company. The company management is exclusively male.

	The Parent Company	
Absence due to sickness	2004	2003
Total absence due to sickness	1.0%	3.8%

No breakdown is provided because there are fewer than 10 employees in each sub-category.

Note 8. Deferred tax

	The Group		The Parent Company	
	2004	2003	2004	2003
Non-booked tax receivable in respect of unutilised deficit deductions	16,196	14,274	16,196	14,274

There is no time limit on the use of the non-booked tax receivable in respect of unutilised deficit deductions.

Note 9. Depreciation, amortisation and write-downs of fixed assets

Depreciation, amortisation and write-downs of tangible and intangible fixed assets were effected as shown below:

	The Group		The Parent Company	
	2004	2003	2004	2003
Depreciation, amortisation and write-downs	6,946	6,878	6,255	6,187

Note 10. Operational leasing agreements

The nominal value of future minimum leasing charges in respect of operational leasing agreements breaks down as follows:

	The Group		The Parent Company	
	2004	2003	2004	2003
Falls due for payment within one year	1,900	1,506	1,900	1,506
Falls due for payment after more than 1 but fewer than 5 years	1,870	230	1,870	230
Falls due for payment after more than 5 years	0	0	0	0

Note 11. Patents, licences and similar rights

	The Group		The Parent Company	
	2004	2003	2004	2003
Patents and licences				
Opening acquisition value	50,938	49,280	50,938	49,280
New acquisitions	792	1,658	792	1,658
Closing accumulated acquisition value	51,730	50,938	51,730	50,938
Opening amortisation	-17,298	-12,792	-17,298	-12,792
Amortisation for the year	-4,534	-4,506	-4,534	-4,506
Closing accumulated amortisation	-21,832	-17,298	-21,832	-17,298
Closing residual value according to plan	29,898	33,640	29,898	33,640

Write-down tests have been carried out within Probi in 2004 to determine the value on 31st December 2003 and 31st December 2004. These tests have indicated that there is no need for write-downs.

Note 12. Goodwill

	The Group		The Parent Company	
	2004	2003	2004	2003
Goodwill				
Opening acquisition value	6,907	6,907	-	-
Closing accumulated acquisition value	6,907	6,907	-	-
Opening amortisation	-4,145	-3,454	-	-
Amortisation for the year	-691	-691	-	-
Closing accumulated amortisation	-4,836	-4,145	-	-
Closing residual value according to plan	2,071	2,762	-	-

The goodwill item is amortised over 10 years when this item is related to the strategic acquisition in 1998 of shares in Probi Food AB.

Write-down tests have been carried out within Probi in 2004 to determine the goodwill value on 31st December 2003 and 31st December 2004. These tests have indicated that there is no need for write-downs.

Note 13. Buildings and land

	The Group		The Parent Company	
	2004	2003	2004	2003
Buildings and land				
Opening acquisition value	4,642	4,642	4,642	4,642
Closing accumulated acquisition value	4,642	4,642	4,642	4,642
Opening depreciation	-364	-204	-364	-204
Depreciation for the year	-161	-160	-161	-160
Closing accumulated depreciation	-525	-364	-525	-364
Closing residual value according to plan	4,117	4,278	4,117	4,278
Rateable value of land in Sweden	561	561	561	561
Rateable value of buildings in Sweden	1,339	1,339	1,339	1,339

The value of land accounts for SEK 1,247 thousand of the total reported value.

Notes

Note 14. Inventories, tools and installations

	The Group		The Parent Company	
	2004	2003	2004	2003
Inventories				
Opening acquisition value	12,019	10,535	12,019	10,535
Purchases	1,145	936	1,145	936
Redistribution implemented during the year	0	548	0	548
Closing accumulated acquisition value	13,164	12,019	13,164	12,019
Opening depreciation	-6,412	-4,891	-6,412	-4,891
Depreciation for the year	-1,560	-1,521	-1,560	-1,521
Closing accumulated depreciation	-7,972	-6,412	-7,972	-6,412

	The Group		The Parent Company	
	2004	2003	2004	2003
Closing residual value according to plan	5,192	5,607	5,192	5,607

New construction work in progress and advances in respect of tangible assets

	The Group		The Parent Company	
	2004	2003	2004	2003
Opening balance	0	548	0	548
Redistribution implemented during the year	0	-548	0	-548
Closing balance	0	0	0	0

Note 15. Participations in Group companies

	The Parent Company	
	2004	2003
At start of year	4,031	4,031
New acquisitions	-	-
Book value	4,031	4,031

Specification of the Parent Company's shareholdings in Group companies.

The Parent Company	Share in capital	Share in votes	Number of shares	Book value
Probi Food AB, 556354-1951, Lund	100%	100%	10,000	3,931
Probi Feed AB, 556540-4364, Lund	100%	100%	1,000	100

Note 16. Prepaid costs and accrued income

	The Group		The Parent Company	
	2004	2003	2004	2003
Prepaid rents	428	423	428	423
Other items	528	518	528	518
Total	956	941	956	941

Note 17. Shareholders' equity

	The Group		The Parent Company	
	2004	2003	2004	2003
Share capital				
Amount at start of year	41,113	41,113	41,113	41,113
New share issue	5,714	0	5,714	0
Amount at year-end	46,827	41,113	46,827	41,113
Restricted reserves				
Share premium reserve/Statutory reserve				
Amount at start of year	20,569	34,697	21,951	35,388
New share issue	31,427	0	31,427	0
New share issue costs	-5,157	0	-5,157	0
Allocation of previous year's result			-7,489	-13,437
Transfer between restricted and non-restricted equity	-4,384	-14,128		
Amount at year-end	42,455	20,569	40,732	21,951
Total restricted shareholders' equity at year-end	89,282	61,682	87,559	63,064

Non-restricted equity

Amount at start of year	-3,341	-9,289	-7,489	-13,437
Allocation of previous year's result			7,489	13,437
VAT reversed	750	0	750	0
Transfer between restricted and non-restricted equity	4,384	14,128		
Net result for the year	-7,366	-8,180	-6,675	-7,489
Total non-restricted shareholders' equity/loss carried forward at year-end	-5,573	-3,341	-5,925	-7,489

The share capital comprises 9,365,300 shares with a nominal value of SEK 5. The "VAT reversed" item refers to a deduction claimed in respect of the new share issue in 2000, which was granted in its entirety.

Note 18. Other long-term liabilities

	The Group		The Parent Company	
	2004	2003	2004	2003
Liabilities to credit institutions, 1-5 years	546	546	546	546
Liabilities to credit institutions, >5 years	3,235	3,372	3,235	3,372
Liabilities to Group companies, >5 years	0	0	0	0
Total	3,781	3,918	3,781	3,918

Note 19. Accrued costs and prepaid income

	The Group		The Parent Company	
	2004	2003	2004	2003
Accrued holiday pay	189	143	189	143
Social security contributions	311	262	311	262
Periodised licensing revenues	1,810	6,537	1,810	6,537
Other items	678	768	678	768
Total	2,988	7,710	2,988	7,710

Note 20. Pledged assets and contingent liabilities

	The Group		The Parent Company	
	2004	2003	2004	2003
Real estate mortgages	3,300	3,300	3,300	3,300
Floating charges	800	800	800	800
Total pledged assets	4,100	4,100	4,100	4,100

There are no contingent liabilities.

Note 21. Transactions with associated companies

No purchases or sales have occurred between Group companies.

Transactions with associated companies reported in the Income Statement:

	The Group		The Parent Company	
	2004	2003	2004	2003
Skånemejerierna (goods)	725	480	725	480
Skånemejerierna (royalty revenues)	24,268	22,535	24,268	22,535
Total income	24,993	23,015	24,993	23,015
Skånemejerierna (royalty costs)	-321	-214	-321	-214
H&B Capital Advisers AB (fee)	-93	0	-93	0
Total costs	-414	-214	-414	-214

Skånemejerierna and H&B Capital Advisers AB are Probi's biggest shareholders. The transactions have been conducted on commercial terms and at market value. The Parent Company has an agreement with Skånemejerierna comprising licensing and service agreements. Royalties from Skånemejerierna are based on these long-term agreements.

The only receivables and liabilities that exist between Skånemejerierna and Probi relate to the operations, and there are no receivables or liabilities between Probi and H&B Capital Advisers.

The Auditors' Report

Lund, 15th February 2005



Peter Zakrisson
Chairman



Rolf Bjernell



Birgit Stattin-Norinder Berthold Lindqvist



Mats Lidgard



Göran Molin



Per Bengtsson
CEO

→ **TO THE ANNUAL GENERAL MEETING OF THE SHAREHOLDERS OF PROBI AB (PUBL), SWEDISH COMPANY REGISTRATION NUMBER 556417-7540**

We have audited the annual accounts, pages 22-23, the consolidated accounts, the accounting records and the administration of the Board of Directors and the CEO of Probi AB (publ) for the financial year 2004. These accounts and the administration of the company are the responsibility of the Board of Directors and the CEO. Our responsibility is to express an opinion on the annual accounts, the consolidated accounts and the administration based on our audit.

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

The annual accounts and the consolidated accounts have been prepared in accordance with the Swedish Annual Reports Act and thereby give a true and fair view of the company's and the Group's financial position and results in accordance with generally accepted accounting principles in Sweden. The Directors' Report is compatible with the other sections of the annual accounts and the consolidated accounts.

We recommend to the Annual General Meeting of Shareholders that the Income Statement and the Balance Sheet of the Parent Company and the Group be adopted, that the loss of the Parent Company be dealt with in accordance with the proposal in the Directors' Report, and that the Members of the Board of Directors and the CEO be discharged from liability for the financial year.

Malmö, 16th February 2005

Öhrlings PricewaterhouseCoopers AB



Lars Helgesen
Authorised Public Accountant
Principal Accountant



Eric Salander
Authorised Public Accountant

The Board of Directors



Peter Zakrisson

Born in 1961. Chairman of the Board since 2002. Member of the Board since 2001. Education: M.Sc. from Lund University/Stockholm University. Founding partner of H&B Capital since 2000. Other directorships: Besthand AB, Cellavision AB and Gatenbeck, Zakrisson Holding AB, etc. Holding in the company: 0 shares.



Rolf Bjerndell

Born in 1951. Member of the Board since 1996. Member of the Board and Chairman of the Board between 1996 and 2000. Education: M.Sc. from Lund University. CEO of Skånemejerierna since 1994. Chairman of the Chamber of Commerce and Industry in Southern Sweden. Other directorships: Sydkraft Nät AB, Carl Bro Sverige AB, Ellco Foods AB etc. Holding in the company: 6,775 shares.



Birgit Staffin-Norinder

Born in 1948. Member of the Board since 2002. Education: Pharmacist. Other directorships: PhotoCure ASA, Artimplant AB, Antisoma plc. etc. Holding in the company: 0 shares.



Berthold Lindqvist

Born in 1938. Member of the Board since 1998. Education: Engineer, M.D. hc, Lund University, 1999. Other directorships: Munters AB (Chairman), Securitas AB, Trelleborg AB, JM AB, Cardo AB, Novotek AB etc. Holding in the company: 57,500 shares.



Göran Molin

Born in 1949. Member of the Board since 1998. Education: Doctorate from the Royal College of Veterinary Surgeons in Stockholm in 1976. Doctorate in microbiology from Lund University in 1984. Professor of Food Hygiene at Lund University. Göran Molin was part of the group of researchers who founded Probi AB. Holding in the company: 537,615 shares.



Mats Lidgard

Born in 1954. Member of the Board since 2004. Education: LL.B., Lund University, 1980. Deputy CEO of SBL Vaccin AB. Other directorships: Unitech AB, Matfors AB and Synphora AB. Holding in the company: 1,000 shares.

Auditors

Öhrlings PricewaterhouseCoopers AB.
Principal Auditor: Lars Helgesen, Malmö.

The Senior Management



Per Bengtsson

Born in 1954. CEO and Head of Research and Development.
Education: University medical degree from the Karolinska Institute. Registered physician. M.D. in cellular biology from Linköping University.
Background: Per Bengtsson took over as CEO in November 2003 and as Head of Research and Development in January of the same year. He has worked in the biotechnology and pharmaceutical industry for 15 years, most recently at Pharmacia AB as Head of Research and Development for Plasma Products. Other companies in which Per Bengtsson has held senior positions include Ferring and Karo Bio.
Holding in the company: 3,000 shares and 40,000 stock options*.

Per-Ola Forsberg

Born in 1961. CFO and Head of Administration.
Education: Degree in economics and business administration from Lund University.
Background: Per-Ola Forsberg was employed in November 2000 as CFO and Head of Administration. Immediately prior to this, Per-Ola Forsberg was the Controller at Rexam Beverage Can Fosite AB, and before that, he was employed as Head of Administration at PolyPeptide Laboratories (Sweden) AB (1994–1998).
Holding in the company: 2,400 shares and 20,000 stock options*.

Jan Alenfall

Born in 1962. Assistant Head of Research and Development.
Education: Degree in Biochemistry. Doctorate in pharmacology from Lund University, specialising in the biology of tumours.
Background: Jan Alenfall has worked in the pharmaceutical industry for 14 years at Pharmacia, Ferring, Bioglan and Skye-Pharma. He was also part of the management group at the Swedish units of Bioglan and Skye-Pharma. Jan Alenfall took over as Assistant Head of Research and Development at Probi in April 2004, and is a member of the management group.
Holding in the company: 1,000 shares.

Niklas Bjärum

Born in 1963. Head of Marketing and Sales.
Education: Degree in international economics from Lund University.
Background: Niklas Bjärum was employed in February 2001 and was put in charge of the company's marketing and sales. Since taking his degree in 1988, Niklas has worked in a number of positions in Marketing, Sales and Business Development of both an operational and a strategic nature at international food companies, such as Nestlé and Masterfoods (Mars Inc.). In 1998, he changed industry and worked for three years at Ericsson Mobile Communications, where he was responsible for Business Development for the European market.
Holding in the company: 2,000 shares.

* See also Note 7 on page 31

The Probi share

Quotation on the O-list in 2004

Probi's share was quoted on the O-list of the Stockholm Stock Exchange on 2nd December 2004, after having been previously quoted on the NGM Equity list of shares since 1998. A new share issue was implemented in conjunction with the quotation on the O-list, and a certain number of shares were sold by major shareholders in order to improve the share's liquidity. There was a simultaneous share amalgamation whereby five old shares yielded one new share, and the division between class A and class B shares was abolished. On 31st December 2004, the closing price for the Probi share was SEK 30.00 (SEK 40.00), corresponding to a market value of SEK 281 million (SEK 328.9 m). The highest price paid during the year was SEK 47.50 (10th February), and the lowest was SEK 29.00 (16th December).

A total of 443,060 shares were traded in December, corresponding to 4.7 per cent of the total number of outstanding shares. On a yearly basis, this means that 56.8 per cent of the total number of outstanding shares were traded.

Share capital

Probi's share capital at the end of 2004 totalled SEK 46,826,500 (SEK 41,112,500), spread over 9,365,300 shares with equal voting rights and equal entitlement to a share in the company's profits and assets. The nominal value of the share is SEK 5. Probi's shareholders' equity totals SEK 83.7 million after the net result for the year.

Number of shareholders and ownership breakdown

The total number of shareholders registered with VPC (the Swedish CSD) on 30th December 2004 was 5,297 (4,859). At the turn of the year, Probi's ownership broke down as follows:

48.9 per cent private ownership, 11.9 per cent owned by institutions, and 16.3 per cent foreign ownership.

Principal owners

Probi's two principal owners, Skånemejerierna and H&B Capital, jointly control approximately 23.6 per cent of the votes and capital.

Stock options programme

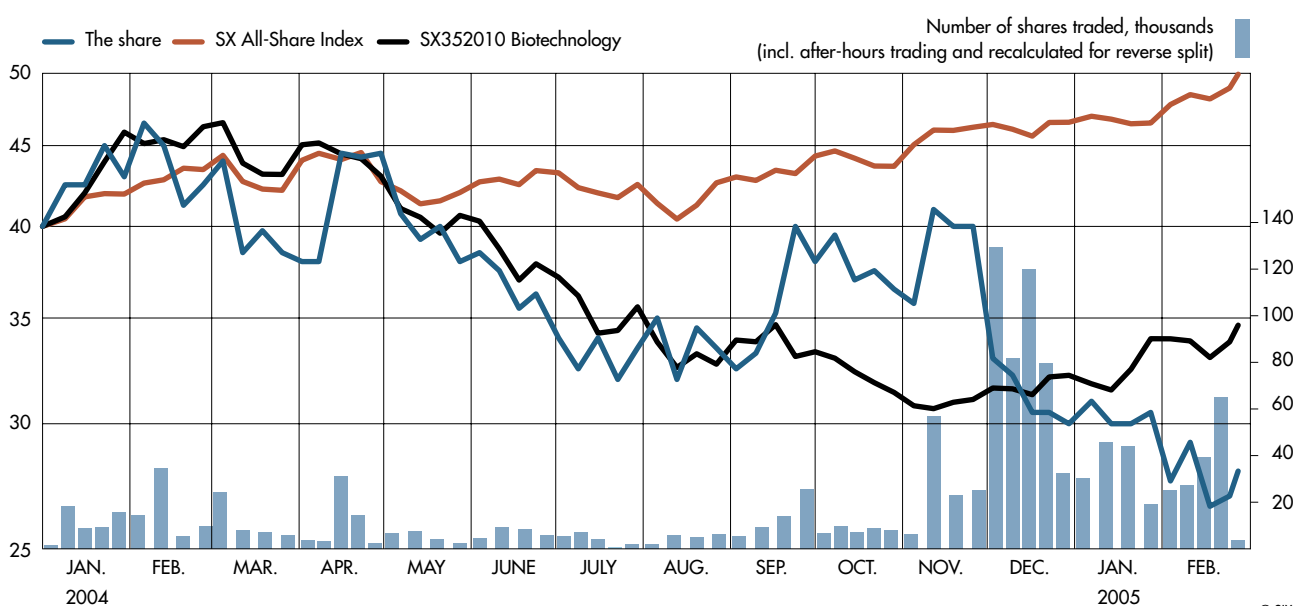
The principal owners issued a stock options programme to the CEO and a member of the management group in 2004, corresponding to 40,000 and 20,000 stock options respectively. The options were acquired on market terms and entitle their holders to buy shares at a price of SEK 44 during the period from 1st January 2007 to 31st August 2007.

Probi currently has no other outstanding option or share-related incentive programmes whereby the company has issued or made available warrants, convertible debentures, stock options, synthetic options or similar financial instruments. The warrants programme for employees and key individuals that expired in May 2004 did not result in subscription for any shares.

Dividend policy

Probi's operations over the next three years will utilise considerable resources and the company is therefore of the opinion that no dividend will be paid until 2007.

Provided that Probi has achieved a suitable capital structure after this period, and that it is felt that the company's financial goals can be maintained, Probi estimates that its share will thereafter yield a dividend totalling 30-50 per cent of the result after tax.



Share capital development

Event	Year	Issue price	Increase in number of shares	Total number of shares	Nominal value per share	Increase in share capital	Share capital
Formation	1991		500	500	100	50,000	50,000
Scrip issue 1:1	1997		500	1,000	100	50,000	100,000
Directed share issue ¹	1997		150	1,150	100	15,000	115,000
Split from 100 to 1	1997		113,850	115,000	1.00	0	115,000
Scrip issue 34:1	1998		3,910,000	4,025,000	1.00	3,910,000	4,025,000
Directed share issue ²	1998		1,006,250	5,031,250	1.00	1,006,250	5,031,250
Scrip issue 15:10	1998		7,546,875	12,578,125	1.00	7,546,875	12,578,125
Directed share issue ³	1998	12	1,721,875	14,300,000	1.00	1,721,875	14,300,000
Scrip issue 13:10	1998	–	18,590,000	32,890,000	1.00	18,590,000	32,890,000
New share issue with preferential rights	2000	10	8,222,500	41,112,500	1.00	8,222,500	41,112,500
Reverse split 5:1	2004		–	8,222,500	5.00	–	41,112,500
New share issue	2004		1,142,800	9,365,300	5.00	5,714,000	46,826,500

¹ The issue was directed at founders and senior executives.

² The issue was directed at Skånemejerierna's ownership group and at Probi AB.

³ The issue was directed at participation holders in Skånemejerierna, Probi AB and Skånemejerierna personnel, and certain other associated parties.

Data per share

	2004	2003	2002	2001	2000
Number of shares as of 31 st Dec., thousand	9,365	8,223	8,223	8,223	8,223
EPS, SEK	-0.79	-0.99	-1.72	-1.45	-1.83
Shareholders' equity per share, SEK	8.94	7.10	8.09	9.81	12.29
Cashflow per share, SEK	2.86	0.10	-3.64	-3.38	9.36
Share price on 31 st Dec. (final price paid), SEK	30.00	40.00	15.00	29.50	47.50
Price/Shareholders' equity per share, multiple	3.36	5.64	1.85	3.01	3.86
P/E ratio, multiple	neg.	neg.	neg.	neg.	neg.
Dividend, SEK	–	–	–	–	–
Market capitalisation on 31 st Dec., SEK thousand	280,959	328,900	123,338	242,564	390,569

The values in the above table do not correspond to those in the formal accounts because they have been recalculated for the 5:1 split employed.

Shareholders

	No. shares	Percentage of share capital and votes, %
Skånemejerier Ek för	1,125,403	12.01
H & B Capital Lp	1,088,442	11.62
KI Chem AB	566,333	6.05
Jeppsson, Bengt	407,517	4.35
Fonden Pecunia	328,600	3.51
Hagströmer & Qviberg Fondk AB	309,671	3.31
Molin, Göran	264,215	2.82
Ahrné, Siv	235,073	2.51
Johannesson, Eskil	219,750	2.35
Lönner, Clas	212,568	2.27
Other (5,287)	4,607,728	49.20
Total	9,365,300	100.00

Shareholding per shareholder

Share distribution	No. owners	No. shares	Percentage of shares, %
1–500	3,848	698,438	7.46
501–1,000	707	521,654	5.57
1,001–5,000	621	1,324,103	14.14
5,001–10,000	67	455,826	4.87
10,001–15,000	13	160,807	1.72
15,001–20,000	4	67,040	0.72
20,001–	37	6,137,432	65.53
Total	5,297	9,365,300	100.00

Glossary

Bacterial strain Bacteria are microscopic organisms that consist of a single cell. A bacterial strain is an "individual" and comprises bacteria with the same genetic identity.

Clinical documentation Documentation of clinical trials.

Clinical nutrition Specialised nutritional and food products intended for use in hospitals and outpatient care with patients whose general health is poor or who are seriously ill.

Clinical trials Studies of food or pharmaceutical products on humans.

Dietary supplement Food intended for use as a complement to a normal diet and which comprises concentrated sources of nutritional substances or other substances with a nutritional or physiological effect, whether separately or collectively. Dietary supplements are sold in individual doses, e.g. capsules, tablets or portion sachets.

Enteral nutrition Medical concept involving the supply of nutrition to the stomach or intestine via a feeding tube or by mouth. See also parenteral nutrition.

Functional food Food products that have been enriched with one or more ingredients that have positive effects on health over and above the normal nutritional value of the product.

IBS Irritable Bowel Syndrome The condition is regarded as one of biggest public health problems in the western world.

Lactobacilli A strain of bacteria that is part of the lactic acid family of bacteria, which is closely associated with various human mucosal linings and is often used in the acidification of foods.

Patent Intellectual property right that protects inventions or technical solutions. Patents grant sole right to use the patented item commercially.

Probiotics Living microorganisms that have positive effects on human health when ingested in sufficient quantities.

Product concept A concept or product prototype that requires development before it becomes an end-product.

Product-specific health claims A health claim for a unique product whose scientific documentation has been reviewed by the Swedish Nutrition Foundation, for example.

Royalty Payment for use of an intellectual property right where the amount paid is linked to the scale of the sales.

Swedish Nutrition Foundation The Foundation's objective is to promote scientific research into nutrition and associated fields, and to promote the practical utilisation of advances made in this field of research. Responsible for reviewing scientific documentation that forms the basis for product-specific health claims for functional food.

Therapeutic field Sphere of use or treatment of a product, e.g. problems relating to the immune system or IBS.

Thoroughly documented The term is used to refer to a product's demonstrated positive effects on health, as proven in extensive clinical studies.

The Annual General Meeting

Notice convening the Annual General Meeting

The shareholders of Probi AB (publ) are hereby notified of the Annual General Meeting of the company's shareholders to be held on Tuesday 10th May at 3 p.m. at the Scandic Hotel Star Lund, at Glimmervägen 5 in Lund. Notices convening the Annual General Meeting will be placed in Svenska Dagbladet and Post- och Inrikes Tidningar (the Official Swedish Gazette). In order to be entitled to participate in the Meeting, shareholders must both be registered in the Register of Shareholders maintained by Värdepapperscentralen, VPC AB (the Swedish CSD) on 30th April, which means that applications to register must be submitted to VPC no later than 29th April, and have notified Probi of their intention to participate in the Meeting no later than 3rd May.

Shareholders whose shares are nominee-registered must temporarily re-register their shares in their own name with VPC to be entitled to participate in the Meeting. Such registration must be effected no later than 29th April 2005, and shareholders must therefore notify the nominee of their request to that effect in good time.

Applications to participate in the meeting shall be submitted, no later than 3rd May, by post to Probi AB, SE-223 70 Lund, Sweden, by fax on +46 (0)46 286 89 28, by phone on +46 (0)46 286 89 20 or by e-mail to probi@probi.se.

Financial reporting dates

- Interim Report, January–March 2005, 26th April 2005
- 2004 Annual General Meeting, 10th May 2005
- Interim Report, April–June 2005, 26th July 2005
- Interim Report, July–September 2005, 26th October 2005
- Preliminary financial statement for 2005, 15th February 2006

