



2008 | annual report

Merrion Pharmaceuticals plc

Annual report and financial statements

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Merrion Pharmaceuticals plc

Introduction to Merrion Pharmaceuticals plc

Merrion Pharmaceuticals plc (also referred to hereafter as “we”, “our”, “us”, “Merrion” and “the company”) is a specialty pharmaceutical company, engaged in the development of oral forms (tablets/capsules) of drugs that have poor absorption and are generally given by injection. Merrion was established in 2003 to commercialise various technologies acquired from Elan Corporation, plc. Merrion's patented drug delivery technologies increase bioavailability, by improving absorption in the gastrointestinal tract, of drugs that are otherwise poorly absorbed. This can provide substantial benefit in patient convenience and safety, and might also provide enhanced drug efficacy. Merrion utilises its technology to develop new oral drugs in two ways; it develops its own proprietary drugs using GIPET® and partners with other pharmaceutical companies in developing oral GIPET formulations of their products.

Merrion currently has four internal product development programs based on its GIPET technology, as follows:

- Orazol™ (MER 101) is an oral bisphosphonate for oncology indications currently in Phase II development. This product aims to allow cancer patients with bone metastases to take a weekly tablet to get the best current standard of treatment in this area, rather than an IV infusion.
- Almerol (MER 103) which is also an oral bisphosphonate, for the treatment of osteoporosis, has completed Phase II clinical trials. Based on the market leading drug, this programme aims to provide similar absorption with just 8% of the current dose, and a simplified dosing regimen with an improved side effect profile.
- Acyline (MER 104) is a second oral oncology product for the treatment of prostate cancer, which is in Phase I clinical testing. This programme aims to be the first oral product in the area of GnRH analogues. Products in this class also have several other male/female health indications.
- MER 102, an oral anticoagulant, is in preclinical testing. This programme aims to be the first oral product in LMWH class of drugs, and to offer patients the alternative to daily injections.

On 16 January 2009, Merrion announced the execution of a development and license agreement with Novo Nordisk A/S (“Novo Nordisk”), a world leader in diabetes, to develop and commercialise oral formulations of a Novo Nordisk proprietary GLP-1 receptor agonist, using Merrion’s proprietary GIPET technology. This is the second license agreement between Merrion and Novo Nordisk concerning Merrion’s GIPET technology. The first agreement for the development of oral insulin analogues was signed on 24 November 2008. Under both license agreements, Merrion may receive up to US\$58.0 million each, for the first product developed which reaches the market based on the achievement of certain development, regulatory and sales milestones, as well as development fees and royalties on sales.

Merrion has operations in Dublin, Ireland and Wilmington, NC, USA.

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Directors and other information

Directors	Patrick O’Sullivan, <i>Chairman and Non-Executive Director</i> John Lynch, <i>Chief Executive Officer, Director</i> Anthony Carragher, <i>Non-Executive Director</i> Michael Donnelly, <i>Non-Executive Director</i> Michael J. McKenna, Ph.D, <i>Non-Executive Director</i> Fintan Maher, <i>Non-Executive Director</i> Harry Stratford, <i>Senior Independent Non- Executive Director</i> Peter Thornton, <i>Independent Non-Executive Director</i>
Company secretary	Jonathan O’Connell
Registered office	Third Floor Biotechnology Building Trinity College Dublin Dublin 2 Republic of Ireland
Solicitors	BCM Hanby Wallace Solicitors 88 Harcourt Street Dublin 2 Republic of Ireland
Independent auditor	KPMG Chartered Accountants 1 Stokes Place St Stephen’s Green Dublin 2 Republic of Ireland
Bankers	Allied Irish Banks plc 1 – 4 Lower Baggot Street Dublin 2 Republic of Ireland
Registrars	Computershare Heron House Corrig Road Sandyford Industrial Estate Dublin 18 Republic of Ireland
Registered number	443434

Merrion Pharmaceuticals plc

Chairman's Statement

Company progress

I am pleased to report that 2008 was a year of very considerable progress for the company in relation to both partner product development programmes and in-house product development programmes.

In November 2008, the company signed a breakthrough US\$58 million development and license agreement with Novo Nordisk A/S ("Novo Nordisk") to develop and commercialise oral formulations of Novo Nordisk proprietary insulin analogues using the company's absorption enhancing GIPET® technology. In January 2009, Merrion signed a second license agreement for US\$58 million with Novo Nordisk for the development of a separate class of compounds, oral GLP-1 agonists. These deals are key for Merrion. The use of GIPET technology to develop oral insulin analogues and GLP agonists validate the technology's broad based potential.

During the year, the company also commenced an oral formulation development programme with the Swiss based international pharmaceutical company, Ferring Pharmaceuticals. This programme is also based on the company's absorption enhancing GIPET technology.

Orazol™ is the company's in-house developed tablet formulation of zoledronic acid, a treatment for bone metastases in cancer patients normally administered by intravenous infusion. Patient enrolment for the ongoing phase IIb study of Orazol was substantially completed by year end (and completed by February 2009). During the year the potential future market for Orazol™ was considerably enhanced following publication of broad based research results showing new, anticancer effects in breast cancer treatment with zoledronic acid.

Almerol™, the company's in-house developed enhanced tablet formulation of alendronate, received the Frost and Sullivan 2008 Osteoporosis Technology Innovation Award, a prestigious US based award. This was in recognition of the increased bioavailability, safety and convenience of Almerol as compared to the currently marketed formulation of alendronate.

Board of directors

In September 2008, Jim Manuso stepped down from the board after more than three years of invaluable service. In December 2008, we were fortunate to welcome Harry Stratford as an independent non-executive director. Harry Stratford's impressive record in leading the international growth and development of two significant UK public pharmaceutical companies (Shire Pharmaceuticals and Prostrakan) is a very valuable resource for the company to draw on.

After year end, my predecessor as Chairman, Dr. Michael J. McKenna, decided to relinquish his chairmanship of the board, while remaining as a non-executive director. As former CEO and as Chairman, Dr. McKenna's role was pivotal in the initial establishment of the company and in guiding it through its successful Initial Public Offering ("IPO") on the Irish Enterprise Exchange ("IEX") in 2007. We are very grateful that Dr. McKenna has consented to retain his board membership.

Management and personnel

The company's senior management team, under the strong leadership of CEO, John Lynch, has clearly shown that it has the capability to rapidly drive the future growth of the business through the application of the company's patented technologies in the development of new and improved medicines, through both partner product development programmes and in-house product development programmes.

In July, Dr. John Fox was appointed as the company's Chief Development Officer. Dr. Fox, has valuable international industry experience in pharmaceutical development, regulatory compliance and project management. His appointment was a significant strengthening of the company's senior management team.

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Chairman's Statement *(continued)*

Management and personnel (continued)

Throughout 2008, increased development activities resulted in a significant increase in the workload of company personnel at every level. It is very gratifying to report that personnel were not found wanting in meeting these much increased demands.

Outlook

Notwithstanding the many difficulties in the general economic environment at present and the associated challenges facing the pharmaceutical industry worldwide, the future prospects of the company remain excellent. As pharmaceutical industry costs come under pressure and as the rate of introduction of new therapeutic advances slows down, the application of the company's patented technologies to enhance the absorption of new and existing therapeutic substances becomes even more relevant.

Corporate governance

I wish to state, on behalf of the board of directors and on behalf of the management team, that we will do our best, individually and collectively, to ensure that the company maintains a consistently high standard of corporate governance and ethical behaviour.

Patrick O'Sullivan
Chairman

Merrion Pharmaceuticals plc

Operating Review

Despite the challenging economic environment we continued to make significant progress at Merrion. In particular, this progress is attributable to the development of a range of projects in 2008, and we are particularly pleased with the Novo Nordisk license agreements, which have the potential to generate greater than US\$116.0 million in milestone payments, plus royalties on future product sales. We have every reason to be optimistic for 2009 and beyond as our progressive team of specialists continue to deliver results which will continue to make important medicines better, safer, easier to use, more convenient and with key economic benefits for healthcare providers.

Partner programs

In November 2008, we entered into a development and license agreement with Novo Nordisk; world leaders in diabetes medicine, potentially worth US\$58.0 million in milestone payments, as well as very significant development fees and potential future royalties. Under this agreement Merrion will work in partnership with Novo Nordisk to develop and commercialise oral formulations of insulin analogues, which are currently being administered in injectable form. Central to this ongoing partnership, which originally commenced in 2007, is the utilisation of Merrion's GIPET® technology. A second development and license agreement, also potentially worth US\$58.0 million in milestone payments, as well as potential future royalties for oral GLP-1 agonists, was entered into in January 2009. The decision by Novo Nordisk to subscribe for 300,000 ordinary shares (1.8% of the issued share capital of the company) further demonstrates the potential for a long partnership between our two companies and also enhances our capacity to develop our other products and technologies.

During September 2008, we entered into an oral drug delivery research programme with Swiss based international pharmaceutical company Ferring Pharmaceuticals, on an undisclosed Ferring compound. This programme focuses on Merrion's GIPET technology, with a view to significantly increasing the subject compound's oral absorption (bioavailability).

Internal projects

During 2008, we conducted a Phase IIb study for Orazol™ (MER 101), in a hormone refractory prostate cancer population at 11 sites in the United States and Europe. In February 2009, we completed the enrolment of patients for this study. This product will allow cancer patients being treated for bone metastases, secondary to a series of cancers, to take a weekly tablet; instead of the once a month infusion they currently receive. Once the dosing is complete, we will analyse and announce the data (expected in Q2, 2009). Then we will look to license Orazol to a suitable partner who will complete the product development, file for registration and market this product, which we believe has significant potential.

Almerol™ (MER 103), is an improved oral dose of Fosamax®, the market leading drug for osteoporosis treatment and it has completed Phase II clinical trials. Almereol provides similar absorption in just 8% of the current dose, with a simplified dosing regimen and an improved side effect profile. Poor compliance with bisphosphonate therapy is a big issue, and Almerol is designed to offer patients a simplified dosing regimen and improved side effect profile, combined with the current gold standard drug for osteoporosis. In recognition of successfully applying our GIPET technology, we were awarded the 'Frost & Sullivan 2008 Osteoporosis Technology Innovation of the Year Award'; a prestigious US based award. This award marked another milestone for Merrion and for the GIPET technology which has led to the development of the innovative new product, Almerol.

In addition Merrion had positive results following the completion of preclinical evaluations of MER 102, our product for deep vein thrombosis and positive results from recent preclinical studies of MER 104, our oral GnRH antagonist for the treatment of prostate cancer and other indications.

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Operating Review *(continued)*

Personnel changes

Over the past twelve months, Merrion has added vital expertise to our formulation, development and clinical development areas. In July 2008, we announced the appointment of Dr John Fox as Chief Development Officer. Dr Fox is responsible for Merrion's Dublin based development operations. With over 20 years of experience in the pharmaceutical industry, Dr Fox's vast experience in this sector provides a crucial link between research, design, development, regulatory and licensing.

A number of changes were made to our board of directors, which saw the appointment of Mr Patrick O'Sullivan and Mr Harry Stratford. Mr O'Sullivan was appointed to the board in May 2008. Mr O'Sullivan is currently chairman of the Board of Trustees of the Beacon Hospital. Before retiring in 2006, he spent over 30 years as Chief Executive Officer of the LEO Pharma Group of companies in Ireland. He was also a board member of the parent company of the LEO Pharma Group in Denmark. He brings to the board a wealth of industry knowledge and a long track record of success.

Mr O'Sullivan was appointed Chairman of the company in February 2009 and replaced Dr Michael McKenna who remains on the board as a non-executive director. As former CEO and as Chairman, Dr. McKenna's role was pivotal in the initial establishment of the company and in guiding it through its successful IPO in 2007. We are very grateful that Dr. McKenna has consented to retain his board membership.

Mr Stratford joined our board in December 2008 and brings with him a wide and varied experience in the pharmaceutical industry. He is the founder and currently executive chairman of Stratford Healthcare – and he was also founder, CEO and Executive Chairman of Prostrakan, the UK listed International specialty pharmaceutical company. He founded Shire Pharmaceuticals in 1986 and was CEO for almost a decade. Having built two successful publicly listed pharmaceutical companies from the ground up, his skills and experience are a vital asset in the further development of Merrion and in achieving the significant goals set for this company.

Mr Pat Wall resigned as a director of the company, due to other work commitments in the early part of 2008. Pat served as a director of Merrion, from the company's founding through its successful Initial Public Offering ("IPO"), in December 2007. We would like to thank Pat Wall for his guidance and his unwavering support of our developing company since its foundation.

Outlook

2009 looks bright for the company. Merrion will continue to add high quality scientists, with strong commercial acumen to our team. We aim to progress with our clinical trials and develop our internal MER products and deliver a quality service to our program partners.

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Financial Review

Income statement

Revenues and cost of sales

Revenues comprise of development fees from partner agreements and the amortisation of up-front milestone payments from licensing agreements. Total revenues were €1.34 million for the year ended 31 December 2008 compared to €0.47 million for the prior year ended 31 December 2007. The 186% increase in revenues was due to the significant increase in collaborative work with Novo Nordisk during 2008.

Our cost of sales consists of direct third-party expenditures, royalty expenses and allocated salaries related to development fees recognised in the year. We had approximately €0.45 million of direct costs associated with our revenues generated for the year ended 31 December 2008 compared to approximately €0.15 million for the year ended 31 December 2007. The increase was due to royalty expenses arising on license agreement revenue generated during the year.

Research and development expenses

Research and development (“R&D”) expenses are comprised of salaries, overhead and consumables, patent costs, share-based compensation expense and clinical trial costs. R&D expenses during the year ended 31 December 2008 increased by 17% to €3.90 million compared to €3.33 million for the year ended 31 December 2007. The increase was due primarily to clinical trials and salary costs. Clinical trial costs increased principally as a result of the Orazol™ (MER 101) Phase II trial which completed enrolment in February 2009. Salary costs increased as additional scientific staff were recruited for our formulation and analytical department.

General and administrative expenses

General and administrative (“G&A”) expenses are comprised of salaries, professional fees, office overhead, share-based compensation expense and other support costs. G&A expenses decreased by 15% to €2.42 million for the year ended 31 December 2008 compared to €2.84 million for the year ended 31 December 2007. Professional fees decreased year over year primarily due to the inclusion of costs in the prior year in conjunction with our IPO in December 2007.

Net finance income/expense

Net finance income was €0.36 million for the year ended 31 December 2008 compared to a net finance expense of €6.22 million for the year ended 31 December 2007. The change year on year was as a result of the elimination of interest expense and finance costs associated with the convertible loan notes issued in April and November 2006 when Merrion was a private company. This prior year non-cash charge was eliminated when the loan notes were converted into ordinary shares on the company’s IPO in December 2007 and therefore no further such charges were required to be recorded in the 2008 financial year.

Net loss

Our net loss was €5.06 million for the year ended 31 December 2008 compared to a net loss of €12.08 million for the year ended 31 December 2007. The reduction in our net loss was primarily due to the elimination of finance expenses associated with loan notes issued by the company in 2006 along with decreases in administrative expenses, offset by increased R&D costs from clinical trials and staff headcount.

Liquidity

Cash and cash equivalents as at 31 December 2008 totalled €8.14 million, a decrease of 25% as compared to €10.87 million as at 31 December 2007. The decrease of €2.73 million was primarily attributable to operating cash outflows of €2.61 million. The primary components of cash used in operating activities were the net loss (adjusted to exclude non-cash operating items), an increase in interest income and a decrease in working capital balances, attributable to an increase in current liabilities due to the timing of payments to suppliers offset by an increase in trade and other receivables.

Overall, the management team is satisfied with the results from the 2008 financial year. With cash and cash equivalents of €8.14 million, Merrion enters into 2009 in a strong financial position.

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Biographies of Directors

The following is a list of the directors and company secretary of the company, together with brief biographies of each.

Patrick O'Sullivan, Chairman & Non-Executive Director

Mr. O'Sullivan was appointed to the board of directors in May 2008. In February 2009, Mr. O'Sullivan was appointed Chairman. Mr. O'Sullivan is a pharmaceutical business consultant and current Chairman of the Board of Trustees of the Beacon Hospital. Prior to retirement in 2006, Mr. O'Sullivan was CEO of the LEO Pharma Group of Companies in Ireland and a board member of the parent company of the LEO Pharma Group in Denmark. He also served on the boards of the LEO Foundation, LEO Pharmaceuticals Ltd., UK and LEO Pharma SA, France. For more than 20 years, Mr O'Sullivan was the chairman of the Pharma Industry team that negotiated the supply of research based pharmaceuticals to the Irish Health Services, on behalf of the Irish Pharmaceutical Healthcare Association Ltd. Mr. O'Sullivan holds Bachelor of Commerce and MBA degrees from University College Dublin; he is a registered pharmacist; a member and honorary fellow of the Pharmaceutical Society of Ireland and a Knight of the Order of the Dannebrog.

John Lynch, Chief Executive Officer & Director

Mr. Lynch has served as Chief Executive Officer since February 2008. Prior to that, he served as Chief Operating Officer from May 2005 and Managing Director from April 2004 to May 2005. He has been a member of the board of directors since April 2005. He is a past chief executive officer of JML Healthcare and divisional director of Abbott Laboratories Limited, a global healthcare company. He has also held positions as Senior Business Development Manager, Abbott International USA; Division Director, Hospital Products and Nutritional Products Divisions, Abbott Laboratories, Ireland, and Financial Director, Abbott Laboratories, Ireland.

Anthony Carragher, Non-Executive Director

Mr. Carragher has served on the board of directors since December 2004. Since January 2005, Mr. Carragher has served as the managing director of Complete Investment Solutions, and from July 2001 to December 2004, he was the investments manager of Irelandia Investments Limited. Mr. Carragher has served on the board of directors of Irelandia II Limited since July 2001 and on the board of directors of Growcorp Group Limited since October 2004.

Michael Donnelly, Non-Executive Director

Professor Donnelly has served on the board of directors since April 2004. Professor Donnelly established Growcorp in January 1999. Prior to establishing Growcorp, he was Vice President and General Manager of Cincinnati Sub Zero Inc., a medical products company in Cincinnati, Ohio, from 1996 to 1998; Vice President of IEP Group, Research Triangle Park, North Carolina from 1993 to 1996; Professor of Pediatrics, College of Medicine, University of Cincinnati, Ohio, and Director of Bioengineering Research at the Perinatal Research Institute, Cincinnati, Ohio from 1986 to 1996; Director of Research and Development from 1983 to 1986; and Director of Marketing from 1980 to 1983 with Air-Shields Inc. Professor Donnelly sits on a number of boards including Growcorp Group Limited, Growcorp (GP) Limited, Gas Sensor Solutions, Fluorocap and Pharmatrin, Orakine, North Wall General Partners, Neutekbio, the Irish Venture Capital Association and Irish Biotechnology Association. He is currently Managing Partner of the European Bioscience Fund.

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Biographies of Directors *(continued)*

Michael J. McKenna, Non-Executive Director

Dr. McKenna was Chairman from February 2008 to February 2009. He previously served as Chief Executive Officer and as a member of our board of directors since April 2004. From April 2004 to April 2006, Dr. McKenna served as chairman of the board. From September 1999 to March 2004, Dr. McKenna served as Vice President of Science and Technology at A.M. Pappas & Associates, LLC, a life sciences venture development company. Previously, he owned and operated Pharmaceutical Consulting Services, advising the biopharmaceutical industry in drug development and drug safety. Prior to this he was Vice President, Drug Development at Parke Davis.

Fintan Maher, Non-Executive Director

Mr. Maher has served on the board of directors since April 2004. Since May 2005, he has served as the managing director of Northwall General Partners Limited. From October 2004 to May 2005, Mr. Maher served as the managing director of Growcorp Group Limited, an investment fund focused on life sciences companies. From June 1999 to September 2004, Mr. Maher was the investments manager of Irelandia Investments Limited.

Harry Stratford, Senior Independent Non-Executive Director

Mr. Stratford was appointed to the board of directors in December 2008. He founded Shire Pharmaceuticals in 1986 and was CEO for almost a decade. Mr. Stratford has over 36 years of wide and varied experience in the pharmaceutical industry. He has built two successful publicly listed pharmaceutical companies from the ground up. He is the founder and currently executive chairman of Stratford Healthcare – and he was also founder, CEO and Executive Chairman of Prostrakan, the UK listed international specialty pharmaceutical company.

Peter Thornton, Independent Non-Executive Director

Mr. Thornton has served on the board of directors since July 2006. In July 2007, Mr. Thornton was appointed Senior Vice President, Head of Product, Technology and Business Development for Elan Drug Technologies. From September 2006 until July 2007, Mr. Thornton served as President and Chief Operating Officer of Circ Pharma Limited, a specialty pharmaceutical product development company. From June 2004 to September 2006, Mr. Thornton served as Senior Vice President and Chief Financial Officer of Antigenics, Inc., a Nasdaq-listed biotechnology company focused on cancer, infectious diseases and autoimmune disorders. From 1994 to 2004, Mr. Thornton held senior management positions in operations and finance with Elan Corporation, plc, most recently as Senior Vice President of Business Operations. Mr. Thornton was previously a director of Antigenics, Inc. and Cydex Pharmaceuticals Inc.

Jonathan O'Connell Chief Financial Officer & Company Secretary

Mr. O'Connell has served as Chief Financial Officer since November 2005. From October 2004 to May 2005, Mr. O'Connell served as Director of Finance of Avaya Inc., a provider of business communications software. From April 2000 to September 2004, Mr. O'Connell was Chief Financial Officer and a member of the board of directors of Spectel plc, a provider of integrated audio and web conferencing solutions. From June 1994 to March 2000, Mr. O'Connell served as Chief Financial Officer and on the board of directors of Trinity Biotech plc, a Nasdaq-listed developer and manufacturer of diagnostic tests. From December 1992 to June 1994, Mr. O'Connell served as Group Financial Controller of Trinity Biotech plc.

Merrion Pharmaceuticals plc

Directors' Report

The directors present the annual report and consolidated and company financial statements for the year ended 31 December 2008 of Merrion Pharmaceuticals plc ("the company").

Principal activities, business review and future developments

Merrion Pharmaceuticals plc and its subsidiaries ("Merrion" or "the group") is a speciality pharmaceutical company engaged in the development of oral dosage forms (tablets/capsules) of drugs that have poor absorption and are generally given by injection.

The financial statements present the financial results and position of the group for the year ended 31 December 2008 and the financial position of the company. The financial statements for each of the periods presented have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"), which are effective for accounting periods ending on or before 31 December 2008.

The directors are satisfied with the results and financial position of the group as at and for the year ended 31 December 2008, details of which have been presented on pages 24 and 25 of the consolidated financial statements. No dividend was paid during the year.

Key performance indicators

Current key performance indicators of the group, used by management to measure performance and exercise control over operations, are summarised below:

Efficient use of funding

The group has incurred losses since its inception in December 2003, primarily from costs incurred in research and development programs and administrative costs. The group expects to continue to incur significant operating expenses in the foreseeable future. For this reason, the close monitoring of the group's working capital is essential to ensure the ability of the group to continue research activities and conduct development programs in order to gain approval and commercialise drug products.

Successful clinical trials

Preclinical and clinical testing is expensive, difficult to design and implement, can take many years to complete and has an uncertain outcome. The group's response to unforeseen events such as failure to gain authorisation from regulators or institutional boards, negative or inconclusive results and enrolment delays is imperative to the efficiency of clinical trials and commercialising the product. Therefore, management monitor the progress of all projects very closely.

To secure development deals with leading pharmaceutical companies

A key element of the business strategy is to collaborate, particularly with leading pharmaceutical companies, to develop and commercialise product candidates and to strengthen and develop relationships with current partners. By developing current partnerships and securing new development deals, the group will obtain growth and sustain its operations.

Achieving milestone objectives

The group has high quality and efficiency standards and seeks to meet all agreed timelines and budgets. It is common for a third party to be contracted to conduct clinical trials on Merrion's behalf. Communication lines are constantly open in order to ensure that trials are progressing in line with expectations and regulatory approvals are not jeopardised.

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Directors' Report (*continued*)

Risk factors

As with any drug development company, the group has a number of business risks. The principal risks are outlined below:

Development risks

The group currently has four internal product candidates based on the GIPET® oral delivery-enabling technology. The business depends primarily on the group's ability to develop commercially viable formulations utilising its technologies, successfully complete clinical trials, obtain required regulatory approvals and successfully commercialise the product candidates. If these clinical trials or any further clinical trials fail, if the group does not obtain required regulatory approvals, or if it fails to commercialise any of the product candidates, Merrion may be unable to generate sufficient revenues to attain profitability or continue business operations and Merrion's reputation in the industry and in the investment community would likely be significantly damaged, each of which would cause the share price to decline and investors to lose all or part of their investment.

Commercialisation risks

A key element of the business strategy is to collaborate, particularly with leading pharmaceutical companies, to develop and commercialise product candidates. The group currently has license agreements with Novo Nordisk but may not be able to negotiate acceptable arrangements with other collaborators. Moreover, such arrangements may involve sharing of profits from sales, requirements to relinquish certain of the rights to the group's products or marketing territories and impositions of other limitations on operations. These arrangements may not be scientifically or commercially successful. The termination of any of these arrangements might adversely affect Merrion's ability to develop and commercialise its product candidates.

Intellectual property risks

Some of the group's product candidates combine the group's GIPET delivery system with certain drug compounds currently protected by patents held by others that are scheduled to expire in the coming years. The group will not be able to commercialise the product candidates before such patents expire without obtaining a license, and such license may not be available on acceptable terms, if at all. In addition, the owners of the patents may be able to obtain extensions on the exclusivity period afforded by such patents, which would further delay the commercialisation of the product candidates unless the company is able to obtain a license.

The group's ability to commercialise its products will depend, in part, on its or its collaborators' ability to obtain patents, to enforce those patents and preserve trade secrets, and to operate without infringing on the proprietary rights of others. Any such inability to achieve meaningful protection could have a material adverse effect on the company by, for example, making it easier for other pharmaceutical companies to enter target markets and compete with future products. The group may also be challenged on its own patent filings which may further delay or prevent the commercialisation of our product candidates. This would have a material adverse effect on Merrion's business, financial condition and prospects.

Financing risks

The group is a development stage enterprise. It is loss making and has negative cash flows. This is common for development companies in the life sciences industry. Up until December 2008, the company has financed its operations and internal growth principally through private placements of debt and equity, and to a significantly lesser extent through revenues under service and license arrangements with pharmaceutical companies. As at 31 December 2008 the group had cash and cash equivalents in excess of €8 million and continues to manage and contain expected future operating costs in order to ensure that sufficient medium term funding is available.

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Directors' Report (*continued*)

Financial risk management

Treasury operations are conducted within a framework of policies and guidelines approved and monitored by the board of directors. The framework allows flexibility for management to carry out board approved strategies. A discussion of the group's financial risk management objectives and policies and exposure of the group to various financial risks is included in note 18 to the consolidated financial statements.

Post balance sheet events

On 12 February 2009, Mr. Patrick O'Sullivan assumed the role of Chairman of the Merrion board of directors. Dr. Michael J. McKenna, Chairman since February 2008, remains as a non-executive director of the group.

In January 2009, the group completed a second development and license agreement for oral GLP-1 agonists with Novo Nordisk. In addition, Novo Nordisk invested €900,000 for a 1.8% shareholding in Merrion Pharmaceuticals plc.

Political and charitable contributions

The company made no political or charitable contributions during the year that require disclosure under the Electoral Act, 1997.

Health and safety of employees

The well being of the group's employees is safeguarded through the strict adherence to health and safety standards. The Safety, Health and Welfare at Work Act, 1989 imposes certain requirements on employers and the Group has taken the necessary action to ensure compliance with the Act, including implementation of appropriate safety guidelines.

Going concern

The directors have a reasonable expectation that the company and the group have adequate resources to continue in operation for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Accounting records

The directors believe that they have complied with the requirements of Section 202 of the Companies Act, 1990 with regard to books of account by employing personnel with appropriate expertise and by providing adequate resources to the financial function. The accounting records of the company are maintained at Third Floor, Biotechnology Building, Trinity College Dublin, Dublin 2, Republic of Ireland.

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Directors' Report *(continued)*

Substantial shareholdings in the company

As of the date of this report the following were the holders of 3% or more of the company's issued ordinary share capital as it was constituted on that date according to the register kept pursuant to Section 80 of the Companies Act, 1990:

	Number of shares	Percentage
Goodbody Stockbroker Nominees	5,632,508	33.8%
European Bioscience Fund I Limited	3,305,221	19.8%
Declan Ryan	2,782,757	16.7%
Growcorp Group Limited	2,608,698	15.7%
Michael J. McKenna	774,198	4.7%
Bank of Kernal Capital Partners	571,163	3.4%

The directors have not been made aware of any other beneficial shareholdings of 3% or more of the issued share capital as at the date of this report.

Directors

In accordance with the Articles of Association, one third of the directors are required to submit themselves for re-election each year. Mr. Fintan Maher, Mr. Michael Donnelly and Mr. Peter Thornton will, being eligible, offer themselves for re-election at the 2008 Annual General Meeting.

Directors and secretary and their interests

The beneficial interests of the directors and company secretary, who held office at 31 December 2008, in the ordinary share capital of the company at the dates below, were as follows:

<i>Interests in share capital</i>	Ordinary shares at par value of €0.01 each	
	At 31 December 2008	At 31 December 2007
Director		
Patrick O'Sullivan	-	-
John Lynch	463,504	463,504
Anthony Carragher	12,345	12,345
Michael Donnelly	37,037	37,037
Michael J. McKenna	774,198	779,198
Fintan Maher	18,518	18,518
Harry Stratford	-	-
Peter Thornton	17,283	17,283
Company secretary		
Jonathan O'Connell	239,952	239,952

At 31 December 2008, the market price of ordinary shares was €3.00, (2007: €4.40) and ranged from €1.61 to €4.25 during 2008, and from €4.05 to €4.40 during 2007.

Except as disclosed in this report, none of the directors or company secretary, who held office at 31 December 2008, had a beneficial interest in the share capital of the company or its subsidiaries and no such interest, the existence of which is known or could with reasonable diligence be ascertained by the relevant director, is held by any connected person.

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Directors' Report *(continued)*

The beneficial interests of the directors and company secretary, who held office at 31 December 2008, in the share options of the company at the dates below, were as follows:

<i>Interests in share options</i>	Date of grant	Exercise price	At 1 January 2008	Granted during 2008	At 31 December 2008	Earliest exercisable date	Expiry date
Director							
Patrick O'Sullivan	19 May 2008	€3.58	-	33,000	33,000	18 May 2009	18 May 2015
			-	33,000	33,000		
John Lynch	9 July 2008	€2.50	-	200,000	200,000	9 July 2009	9 July 2015
			-	200,000	200,000		
Anthony Carragher	12 December 2007	€4.05	25,000	-	25,000	12 December 2008	12 December 2014
	20 October 2008	€2.50	-	8,000	8,000	11 July 2009	19 October 2015
			25,000	8,000	33,000		
Michael Donnelly	12 December 2007	€4.05	25,000	-	25,000	12 December 2008	12 December 2014
	20 October 2008	€2.50	-	8,000	8,000	11 July 2009	19 October 2015
			25,000	8,000	33,000		
Michael J. McKenna	7 April 2006	€0.023	126,156	-	126,156	7 April 2006	7 April 2016
			126,156	-	126,156		
Fintan Maher	12 December 2007	€4.05	25,000	-	25,000	12 December 2008	12 December 2014
	20 October 2008	€2.50	-	8,000	8,000	11 July 2009	19 October 2015
			25,000	8,000	33,000		
Harry Stratford			-	-	-		
Peter Thornton	9 September 2007	€0.023	33,043	-	33,043	18 July 2008	5 October 2013
			33,043	-	33,043		
Company secretary							
Jonathan O'Connell	20 October 2008	€2.50	-	130,000	130,000	11 July 2009	19 October 2015
			-	130,000	130,000		

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Directors' remuneration

The remuneration of the directors of the company for the years ended 31 December 2008 and 2007 was as follows:

	Fees	Salary and bonus	Pension	Benefit in kind	Share - based payments	Total 2008	Total 2007
	€	€	€	€	€	€	€
Executive director							
John Lynch	-	260,000	20,000	2,953	68,071	351,024	230,542
Non executive directors							
Patrick O'Sullivan ⁽¹⁾	15,385	-	-	-	23,800	39,185	-
Anthony Carragher	-	-	-	-	29,518	29,518	1,533
Michael Donnelly	12,500	-	-	-	29,518	42,018	1,533
Michael J. McKenna ⁽²⁾	106,065	10,190	545	-	-	116,800	221,189
Fintan Maher	21,300	-	-	-	29,518	50,818	1,533
James Manuso ⁽³⁾	25,000	-	-	-	42,250	67,250	98,650
Declan Ryan ⁽⁴⁾	-	-	-	-	-	-	1,533
Harry Stratford ⁽⁵⁾	2,083	-	-	-	-	2,083	-
Peter Thornton	25,000	-	-	-	31,500	56,500	98,650
Patrick Wall ⁽⁶⁾	-	-	-	-	-	-	1,533
Total	207,333	270,190	20,545	2,953	254,175	755,196	656,696

(1) Appointed as a director on 21 May 2008.

(2) Salary attributable to former role as CEO until February 2008. Directors' fees comprise fees of €106,065 under a consultancy agreement in respect of advice relating to clinical trials and regulatory affairs strategy.

(3) Retired as a director on 10 September 2008.

(4) Retired as a director on 14 February 2008.

(5) Appointed as a director on 11 December 2008.

(6) Retired as a director on 17 April 2008.

The share-based payment amounts disclosed in the above table represents the share-based compensation expense recognised in the income statement in the year ended 31 December 2008 attributable to each director.

Auditor

In accordance with Section 160(2) of the Companies Act, 1963, the auditor, KPMG, Chartered Accountants, will continue in office.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

27 March 2009

Merrion Pharmaceuticals plc

Corporate Governance Statement

Policies and procedures

The board of Merrion is firmly committed to adopting and maintaining the highest standards of corporate governance. As an IEX listed company, Merrion is not required to comply with the provisions of the revised Combined Code on corporate governance issued by the Financial Reporting Council in June 2006 and subsequently adopted by the Irish Stock Exchange, (“the Combined Code”). However, the directors have undertaken to voluntarily comply with the Combined Code, as far as practicable, having regard to the size and nature of the company. The following statement describes how the provisions of the Combined Code have been applied.

The board of directors

Merrion is led by a strong and effective board of directors. The board of eight members comprises one executive director and seven non-executive directors. The roles of the Chairman, Mr. Patrick O’Sullivan, and Chief Executive Officer, Mr. John Lynch, are separated with a clear division of responsibility between them. Mr. Patrick O’Sullivan was appointed Chairman in February 2009, succeeding Dr. Michael J. McKenna. At the time of appointment as Chairman, Mr. Patrick O’Sullivan met the independence criteria for non-executive directors, as set forth below. Biographies of all directors are set out on pages 8 and 9 of this annual report.

The full board, which met on six occasions during 2008, manages the overall control of the company’s affairs through a schedule of matters specifically reserved for decision at board meetings. These include approval of strategic plans, annual budgets, financial statements, authority levels for capital expenditure items, board appointments, the review of monthly and other management reports and systems of internal control.

The board delegates responsibility for management of the company through the Chief Executive Officer to the executive management team, who are in regular contact with each other. The board also delegates some of its responsibilities to board committees, details of which are set forth below. Formal decisions are communicated throughout the company. The executive management team is responsible for implementing company policy and monitoring the performance of the business and reporting to the full board thereon.

Individual directors may seek independent professional advice in the furtherance of their duties at the company’s expense and all directors have access to the advice and services of the company secretary.

The company has a policy in place which indemnifies the directors in respect of legal actions taken against them.

Committees of the board of directors

The company has established three principal board committees to assist the board in the discharge of its responsibilities. These comprise the audit committee, the compensation committee and the nominating and governance committee. Each of the committees has terms of reference which are formally documented, under which authority is delegated to them by the board.

Audit Committee

The audit committee comprises three non-executive directors. The committee is chaired by Mr. Peter Thornton, who is also the audit committee financial expert. The other members are Mr. Fintan Maher and Mr. Anthony Carragher. Meetings are attended by Mr. Jonathan O’Connell, Chief Financial Officer, upon invitation by the audit committee, as appropriate. The audit committee held three meetings during 2008.

The duties of the committee include monitoring the appropriateness and effectiveness of internal control throughout the company, reviewing the company’s accounting policies and procedures and financial reporting and reviewing the annual financial statements before submission to the board. The audit committee is also responsible for monitoring the independence of the external auditor.

Merrion Pharmaceuticals plc

Corporate Governance Statement *(continued)*

Committees of the board of directors *(continued)*

Audit Committee (continued)

The audit committee reviews and discusses with the external auditor, the company's choice of accounting policies, the independent auditor's report, the company's financial reporting controls and procedures and other related matters. The external auditor has full and unrestricted access to the audit committee.

The committee reviews the need for an internal audit function on a regular basis and, given the size of the company; it does not consider it necessary to operate a separate internal audit function at this time.

Compensation Committee

The compensation committee is comprised of three non-executive directors. The committee is chaired by Mr. Patrick O'Sullivan. The other members are Mr. Michael Donnelly and Mr. Peter Thornton. The compensation committee held three meetings during 2008.

The committee determines the compensation of the Chief Executive Officer, Mr. John Lynch, and reviews the compensation of the non-executive directors and other members of the executive management team, including grants of share options and the terms of service contracts. No director takes any part in discussions concerning his own remuneration.

The policy of the compensation committee is designed to set remuneration levels that are appropriate for our directors and members of the executive management team, having regard to their roles and responsibilities, their individual performance and our performance as a whole. The committee sets remuneration levels in order to attract, retain and motivate individuals, whose remuneration is linked to the overall performance of the company and therefore the interests of shareholders.

Non-executive directors are remunerated by way of directors' fees and share options. While the Combined Code notes that the remuneration of non-executive directors should not include share options, the board believes that the quantum of options granted to non-executive directors is not so significant as to raise any issues concerning their independence. Dr. Michael J. McKenna is also remunerated on a consultancy basis in respect of advice relating to clinical trials and regulatory affairs strategy.

There are no service contracts with directors with notice periods in excess of 12 months.

Details of directors' remuneration and beneficial interests in the share capital of the company are set forth in the directors' report on pages 13 to 15 of this annual report. Details of the remuneration of key management personnel is separately set forth in note 22 to the consolidated financial statements.

Nominating and Governance Committee

The nominating and governance committee is comprised of three non-executive directors. The committee is chaired by Mr. Harry Stratford. The other members are Mr. Patrick O'Sullivan and Mr. Fintan Maher. The nominating and governance committee held two meetings during 2008. The function of this committee includes overseeing the process for evaluating the board of directors and management and the consideration of appointments to the board. On appointment, new directors receive an induction into the group's activities and their responsibilities as directors.

The Articles of Association of the company specify that all directors are required to submit themselves for re-election at regular intervals and at least one third of all directors must submit themselves for re-election each year. Mr. Fintan Maher, Mr. Michael Donnelly and Mr. Peter Thornton will, being eligible, offer themselves for re-election at the 2008 Annual General Meeting ("AGM").

Directors appointed by the board must submit themselves to shareholders for election at the AGM following their appointment. Mr. Harry Stratford will accordingly offer himself for election at the 2008 AGM.

Merrion Pharmaceuticals plc

Corporate Governance Statement (*continued*)

Independence of non-executive directors

Under our guidelines, the board has determined that an independent director is one who has no business relationship with the company or its management which may undermine independence; does not represent a significant shareholder; is not dependent on the company or its management for his primary source of income; was not, in the past five years, an employee of the company; and has not served on the board for more than nine years from the date of their first election.

At the year-end, board membership included two independent non-executive directors, namely Mr. Peter Thornton and Mr. Stratford. Accordingly, pursuant to the requirements of the Combined Code, the composition of the board includes an appropriate number (at least two for small companies) of independent non-executive directors. The company has appointed Mr. Harry Stratford as its senior independent director.

Share ownership and share dealings

The company has adopted a code of directors' dealings appropriate for a company whose shares are trading on the IEX and takes all reasonable steps to ensure compliance by the directors and any relevant employees. The form of this code is substantially the same as the Model Code previously appended to the IEX Rules.

Relationships with shareholders

The directors consider the clear and timely communication of information to shareholders as an important part of their duties in order to ensure the company's strategy and performance is understood.

The company formally communicates with its shareholders by way of its AGM and the annual report and financial statements. The company also publishes its preliminary and interim results on the company's website (www.merrionpharma.com). The interim and year-end financial reports provide a summary of the company's trading performance and future outlook. The company's website also gives shareholders access to additional information including company announcements and board appointments. The board periodically receives presentations on investor perceptions.

The board also views its AGM as an ideal opportunity to communicate with both institutional and private investors alike. A business presentation is provided at the AGM, followed by a questions and answers forum which offers shareholders the opportunity to question board members. Details of proxy voting are announced in respect of each resolution considered at the AGM. The company will arrange for the notice of the 2008 AGM and related papers to be sent to shareholders at least 21 calendar days before the meeting.

Internal control

The board has overall responsibility for the systems of internal control and for monitoring their effectiveness. These systems are designed to provide reasonable, but not absolute, assurance against material misstatement or loss. Implementation and maintenance of internal control systems is the responsibility of executive management. The board, through the audit committee, has reviewed the effectiveness of the systems of internal control for the year ended 31 December 2008 and the subsequent period to the date of approval of the financial statements.

The company has established a framework of internal controls, the key features of which are as follows:

Control environment

There are clearly defined organisational responsibilities and the board is committed to employing suitably qualified staff so that the appropriate level of authority can be delegated with regard to accountability and acceptable levels of risk.

Merrion Pharmaceuticals plc

Corporate Governance Statement *(continued)*

Internal control *(continued)*

Identification and evaluation of business risks and controls

Management control is exercised at all levels in the company and is regulated by appropriate limits of authority. The directors have considered various areas of business risks and have developed appropriate policies to manage and mitigate those risks. These policies are reviewed in light of known and perceived changes to the business and the risks it faces.

Quality and integrity of personnel

The company attaches high importance to the values of trust, honesty and integrity of personnel in responsible positions and operates a policy of recruiting suitably experienced personnel with clearly defined roles and responsibilities.

Project appraisal

All major development projects undertaken by the company are presented to the board for approval. In addition, the board, both in the regular meetings and by ad hoc reports, regularly reviews all potential development projects.

Budgeting

The company's annual budget is approved by the board of directors.

Monitoring

Given the small size and homogenous nature of the company's operations, together with the close involvement of the executive director and the executive management team in the day-to-day operations of the business, no formal internal audit function is considered necessary.

Accountability and audit

The contents of the operating and financial reviews, the directors' report and financial statements (in addition to official company press releases, stock exchange announcements and interim results) have been reviewed in order to ensure a balanced presentation, so that the company's position and results may be properly appreciated by shareholders.

A summary of directors' responsibilities in respect of the financial statements is given on page 18. The systems of internal control and risk management established to safeguard the company's assets is set out above. The audit committee, whose composition and functions are described above, has considered, in conjunction with the external auditor, the accounting policies adopted in the financial statements and has evaluated the internal controls that have been established within the company.

As part of the approval of the appointment of the external auditor, the audit committee has sought confirmation from the external auditor that it is, in its professional judgement, independent of Merrion. The audit committee monitors the nature, extent and scope of the non-audit services provided by the external auditor on an annual basis. Fees attributable to the external auditor during the financial year for audit and non-audit services performed are disclosed in note 7 to the consolidated financial statements.

Corporate social responsibility

The European Commission has published recommendations governing the recognition, measurement and disclosure of environmental issues in the annual reports of companies. Although the provisions of the recommendations are not binding on Merrion in the conduct of its business, the company recognises its social responsibility and endorses the growing trend towards environmental accountability.

Merrion Pharmaceuticals plc

Corporate Governance Statement *(continued)*

Going concern

The directors, having made enquiries, are satisfied that the company as a whole has adequate resources to continue in operational existence for the foreseeable future. Accordingly, it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

Compliance statement

The board has taken the necessary steps to comply, in so far as practicable, with the provisions set out in the Combined Code, except as outlined below. Due to the size of the board and the company, the company has not complied with the following provisions of the Combined Code but will continue to review these areas on an on-going basis:

- While each of the board committees is comprised of non executive directors, some of these non-executive directors are not considered independent. Accordingly, the majority of the members of the audit committee, the compensation committee and the nominating and governance committee are not independent non-executive directors as required by the Combined Code.
- The company Chairman, Mr. Patrick O’Sullivan, also chairs the compensation committee, which contravenes the guidelines under the Combined Code.
- The terms and conditions of appointment of non-executive directors are available for public inspection by contacting the company secretary. However, copies of such terms and conditions are not included on the company’s website, as required by the Combined Code.
- The board does not undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. Effective in fiscal 2009, the board has commenced a formal system of review of its performance.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

27 March 2009

Merrion Pharmaceuticals plc

Statement of directors' responsibilities in respect of the annual report and financial statements

The directors are responsible for preparing the annual report and the group and company financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare group and company financial statements for each financial year. Under that law and in accordance with the IEX Rules, the directors have prepared the group financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and have elected to prepare the company financial statements in accordance with IFRS as adopted by the EU and as applied in accordance with the Companies Acts, 1963 to 2006.

The group financial statements are required by law and IFRS as adopted by the EU, to present fairly the financial position and performance of the group. The Companies Acts, 1963 to 2006 provide in relation to such financial statements that reference in the relevant part of these Acts to financial statements giving a true and fair view are references to their achieving a fair presentation. The company financial statements are required by law to give a true and fair view of the state of affairs of the company.

In preparing each of the group and company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the company will continue in business.

Under applicable law and the requirements of the IEX Rules issued by the Irish Stock Exchange, the directors are also responsible for preparing a directors' report and providing information relating to directors' remuneration and transactions with directors that comply with that law and those Rules.

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Acts, 1963 to 2006. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the Republic of Ireland governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

Independent Auditor's Report to the Members of Merrion Pharmaceuticals plc

We have audited the group and company financial statements of Merrion Pharmaceuticals plc for the year ended 31 December 2008, which comprise the consolidated income statement, the consolidated and company balance sheets, the consolidated and company cash flow statements, the consolidated and company statements of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 193 of the Companies Act, 1990. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") are set out in the Statement of Directors' Responsibilities on page 21.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRS as adopted by the EU, and have been properly prepared in accordance with the provisions of the Companies Acts, 1963 to 2006 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, proper books of account have been kept by the company; whether, at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the company; and whether the information given in the directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the company balance sheet is in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law or the Listing Rules of IEX regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. The other information comprises only the chairman's statement, the operating review, the financial review and the corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Independent Auditor's Report to the members of Merrion Pharmaceuticals plc (continued)

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of affairs of the group as at 31 December 2008, and of its loss for the year then ended;
- the company financial statements give a true and fair view, in accordance with IFRS as adopted by the EU and as applied in accordance with the provisions of the Companies Acts, 1963 to 2006, of the state of affairs of the company as at 31 December 2008; and
- the financial statements have been properly prepared in accordance with the Companies Acts, 1963 to 2006 and Article 4 of the IAS Regulation.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company. The company balance sheet is in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the company, as stated in the company balance sheet on page 26 are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2008 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.



Chartered Accountants
Registered Auditor, Dublin, Ireland

27 March 2009

Merrion Pharmaceuticals plc

Consolidated Income Statement

for the year ended 31 December 2008

	<i>Note</i>	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Revenue - continuing operations	3	1,339,939	469,233
Cost of sales		(447,652)	(153,426)
Gross profit		892,287	315,807
Administrative expenses		(2,419,870)	(2,844,295)
Research and development expenses		(3,897,684)	(3,330,587)
Results from operating activities – continuing operations		(5,425,267)	(5,859,075)
Finance income	4	363,211	491,414
Finance expense	5	(270)	(6,708,189)
Net finance income/(expense)		362,941	(6,216,775)
Loss before income tax	7	(5,062,326)	(12,075,850)
Income tax	8	-	-
Net loss for the year – all attributable to equity holders of the company		(5,062,326)	(12,075,850)
Basic and diluted net loss per ordinary share	9	(0.30)	(1.60)

The accompanying notes are an integral part of these financial statements.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

Merrion Pharmaceuticals plc

Consolidated Balance Sheet

at 31 December 2008

	<i>Note</i>	31 December 2008 €	31 December 2007 €
Non-current assets			
Property, plant and equipment	<i>10</i>	787,606	786,780
Intangible assets	<i>11</i>	-	180,000
Total non-current assets		787,606	966,780
Current assets			
Trade and other receivables	<i>12</i>	752,562	429,332
Cash and cash equivalents	<i>13</i>	8,140,085	10,869,699
Total current assets		8,892,647	11,299,031
Total assets		9,680,253	12,265,811
Non-current liabilities			
Deferred income	<i>14</i>	1,686,241	11,485
Total non-current liabilities		1,686,241	11,485
Current liabilities			
Trade payables		663,526	1,141,489
Deferred income	<i>14</i>	729,572	133,396
Accrued and other payables	<i>15</i>	929,512	844,420
Total current liabilities		2,322,610	2,119,305
Total liabilities		4,008,851	2,130,790
Shareholders' equity			
Share capital	<i>16</i>	166,592	165,838
Share premium	<i>21</i>	58,791,974	58,781,971
Reverse acquisition reserve	<i>21</i>	(25,318,907)	(25,318,907)
Share-based compensation reserve	<i>21</i>	764,853	319,336
Retained loss	<i>21</i>	(28,733,110)	(23,813,217)
Total shareholders' equity		5,671,402	10,135,021
Total liabilities and shareholders' equity		9,680,253	12,265,811

The accompanying notes are an integral part of these financial statements.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

Merrion Pharmaceuticals plc

Company Balance Sheet

at 31 December 2008

	Note	31 December 2008 €	31 December 2007 €
Non-current assets			
Investment in subsidiaries	23a	29,947,673	29,545,827
Total non-current assets		29,947,673	29,545,827
Current assets			
Trade and other receivables	23b	9,920,279	9,920,279
Cash and cash equivalents	23c	9,966	-
Total current assets		9,930,245	9,920,279
Total assets		39,877,918	39,466,106
Current liabilities			
Accrued and other payables	23d	2,444,979	2,344,502
Total current liabilities		2,444,979	2,344,502
Shareholders' equity			
Share capital	23e	166,592	165,838
Share premium	23g	58,791,974	58,781,971
Share-based compensation reserve	23g	764,853	319,336
Retained loss	23g	(22,290,480)	(22,145,541)
Total shareholders' equity		37,432,939	37,121,604
Total liabilities and shareholders' equity		39,877,918	39,466,106

The accompanying notes are an integral part of these financial statements.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

Merrion Pharmaceuticals plc

Consolidated Statement of Cash Flows

for the year ended 31 December 2008

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Cash flows from operations activities		
Net loss for the year	(5,062,326)	(12,075,850)
Adjustments to reconcile net income to net cash generated from operating activities		
Depreciation and amortisation	548,109	414,962
Grant amortisation	(14,322)	(14,333)
Share based compensation expense	587,950	211,281
Net finance (income)/expense	(362,941)	6,216,775
	(4,303,530)	(5,247,165)
Change in trade and other receivables	(281,016)	757,764
Change in trade and other payables	1,676,962	587,859
Cash used by operations	(2,907,584)	(3,901,542)
Interest received	299,848	175,415
Interest paid	(270)	(1,305)
Net cash used in operating activities	(2,608,006)	(3,727,432)
Investing activities		
Purchase of property, plant and equipment	(135,199)	(192,830)
Net cash used in investing activities	(135,199)	(192,830)
Cash flows from financing activities		
Proceeds from share options exercised by employees	10,757	-
Proceeds from exercise of option by shareholder	-	789,474
Repayment of interest bearing loans and borrowings	-	(1,105,125)
Proceeds from issue of share capital	-	8,000,001
Share issue costs	-	(1,848,622)
Net cash provided by financing activities	10,757	5,835,728
Net (decrease)/increase in cash and cash equivalents	(2,732,448)	1,915,466
Effect of exchange rate movements on cash	2,834	(12,557)
Cash and cash equivalents at beginning of the year	10,869,699	8,966,790
Cash and cash equivalents at end of the year	8,140,085	10,869,699

Merrion Pharmaceuticals plc

Company Statement of Cash Flows

for the year ended 31 December 2008

	Year ended 31 December 2008	19 July 2007 (date of incorporation) to 31 December 2007
	€	€
Cash flows from operations activities		
Net loss for the year/period	(287,372)	(22,145,541)
Adjustments to reconcile net income to net cash generated from operating activities		
Loss arising on novation of convertible loan stock during group reorganisation	-	19,975,015
Share-based compensation expense	186,104	101,348
Net non-cash finance costs	-	2,069,178
	(101,268)	-
Change in accrued and other payables	100,477	-
Net cash used in operating activities	(791)	-
Cash flows from financing activities		
Proceeds from share options exercise by employees	10,757	-
Net cash from financing activities	10,757	-
Net increase in cash and cash equivalents	9,966	-
Cash and cash equivalents at beginning of the year/ period	-	-
Cash and cash equivalents at end of the year/period	9,966	-

Merrion Pharmaceuticals plc

Consolidated Statement of Recognised Income and Expense

for the year ended 31 December 2008

	Year ended 31 December 2008	Year ended 31 December 2007
	€	€
Income and expense recognised directly in equity	-	-
Loss for the financial year	(5,062,326)	(12,075,850)
Total recognised income and expense for the year – all attributable to equity holders of the company	(5,062,326)	(12,075,850)

Merrion Pharmaceuticals plc

Company Statement of Recognised Income and Expense

for the year ended 31 December 2008

	Year ended 31 December 2008	19 July 2007 (date of incorporation) to 31 December 2007
	€	€
Income and expense recognised directly in equity	-	-
Loss for the financial year/period	(287,372)	(22,145,541)
Total recognised income and expense for the year/period – all attributable to equity holders of the company	(287,372)	(22,145,541)

Merrion Pharmaceuticals plc

Notes forming part of the consolidated financial statements

Notes 1, 2, 24 and 25 deal with both the consolidated financial statements and the company financial statements. Notes 3 to 22 deal with the consolidated financial statements only. Note 23 deals with the company financial statements only.

1. Basis of preparation

Merrion Pharmaceuticals plc (“the company”) and its subsidiaries (collectively referred to hereafter as “we”, “our”, “us”, “Merrion”, or “the group”) is a speciality pharmaceutical company engaged in the development of oral forms (tablets/capsules) of drugs that have poor absorption and are generally given by injection, and is headquartered in Dublin, Ireland.

Merrion Pharmaceuticals plc was incorporated on 19 July 2007. On 7 September 2007, Merrion Pharmaceuticals plc became the new parent holding company of the group headed up by Merrion Pharmaceuticals Holdings Limited, affected by the transfer of the entire issued share capital of Merrion Pharmaceuticals Holdings Limited to Merrion Pharmaceuticals plc.

These consolidated financial statements are presented in Euro, being the functional currency of the company. They are prepared on the historical cost basis except for share-based payments which are based on fair value determined at the grant date of the relevant share options.

Statement of compliance

As permitted by European Union (“EU”) law and in accordance with IEX Rules, the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the EU, which are effective for accounting periods ending on or before 31 December 2008. The company financial statements have also been prepared in accordance with IFRS as adopted by the EU and as applied in accordance with the Companies Acts, 1963 to 2006, which permits a company that publishes its company and group financial statements together, to take advantage of the exemption in Section 148(8) of the Companies Act, 1963 from presenting to its members its company income statement and related notes which form part of the approved company financial statements.

The financial statements were authorised for issue by the board of directors on 27 March 2009.

Use of judgements and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These estimates are based on historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis of making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates.

Estimates are used in determining items such as the carrying values of property, plant and equipment and intangible assets, revenue recognition and the fair value of share-based payments, among other items. Because of the uncertainties inherent in such estimates, actual results may differ materially from these estimates. These underlying estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if these are also affected.

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies

The accounting policies applied in the preparation of the consolidated and company financial statements for the year ended 31 December 2008 are set out below. These have been applied consistently for all periods presented, except as otherwise set out below.

(a) Basis of consolidation

Subsidiaries are entities controlled by the group. Control exists when the group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated income statement from the date of acquisition or up to the date of disposal. Upon the acquisition of a business, fair values are attributed to the separable net assets acquired.

All intercompany balances and transactions, and any unrealised income and expenses arising from intercompany transactions are eliminated in preparing the consolidated financial statements.

Investments in subsidiaries are shown at cost less accumulated impairment losses in the company financial statements.

(b) Revenue recognition

The group recognises revenue in connection with the performance of feasibility studies on behalf of third party pharmaceutical companies. Revenue also comprises up-front and milestone payments arising from research and development activities performed on behalf of third parties.

Revenue is recognised on a fee-for-service basis as the related service is performed. The difference between the amount of revenue recognised and the amount invoiced on a particular contract is included in the balance sheet as accrued or deferred income. Normally amounts become billable upon the achievement of certain specified conditions, in accordance with pre-agreed payment schedules included in the contract or on submission of appropriate billing detail. Such cash payments are not necessarily representative of revenue earned on the contract as revenues are recognised over the period in which the specified contracted obligations are fulfilled. Advance billings to customers for which revenue has not been recognised, are recognised as deferred income within non-current liabilities and current liabilities.

License revenue comprises non-refundable, up-front license payments and milestone payments. In general, up-front payments are deferred and amortised in line with the period of development. Milestone payments relating to scientific or technical achievement are recognised when they are non-refundable, all obligations related to the revenue have been provided and their collection is reasonably assured.

(c) Cost of sales

Direct costs consist of compensation and associated employee benefits for project-related employees and other direct project related costs.

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(d) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense when incurred.

In-house development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the company intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in the income statement when incurred. To date, the group has not incurred development costs that have met the criteria for recognition as an internally generated intangible asset and as such all development costs have been recognised as an expense in the income statement as incurred.

(e) Employee benefits

Defined contribution plans

The group provides certain employees with post retirement benefits in the form of pensions, through the operation of a defined contribution pension scheme. Costs arising in respect of the group's defined contribution pension scheme are charged to the income statement in the period in which they are incurred. Any contributions unpaid at the balance sheet date are included as a liability. A defined contribution plan is a post employment benefit plan under which an entity pays fixed contributions into a pension scheme and there is no legal or constructive obligation to pay further amounts.

Short term benefits

Short term benefits are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the group has a present legal or constructive obligation to pay this amount as a result of past service and the obligation can be estimated reliably.

Share-based payment transactions

The group engages in equity settled, share-based payment transactions in respect of services received from certain of its employees. Share-based payments are comprised of options to acquire ordinary shares in the company granted to the directors and certain other employees. The grant date fair value of options granted is recognised as an employee expense with a corresponding increase in equity, over the period during which the directors and certain other employees become unconditionally entitled to the options. The fair value of options granted is measured using a binomial option pricing model, which takes into account the terms and conditions upon which the options were granted, including the exercise price of the option, the market share price at date of grant, the risk-free rate of interest, and the expected volatility of the Merrion share price over the life of the option, among other relevant factors. Since the awards are subject to a non-market performance condition, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

In the company financial statements, awards granted to employees of subsidiary companies are accounted for as a capital contribution to the subsidiaries and recorded as an increase in the cost of investment in subsidiaries.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(f) Foreign currency translation

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Euro, which is the functional currency of the majority of the group's entities. For our subsidiaries with non-Euro functional currency, their assets and liabilities are translated using year-end rates and net income is translated at average rates where they represent a reasonable approximation of the actual rates relating to the dates of the underlying transaction. The cumulative effect of exchange differences arising on consolidation of the net investment in overseas subsidiaries is recorded in a separate reserve in shareholders' equity.

Transactions in foreign currencies are translated into the respective functional currencies of group entities at the rates of exchange ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the rate of exchange prevailing at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated to Euro at foreign exchange rates ruling at the dates the transactions were effected. Foreign currency differences arising on retranslation are recognised in profit or loss.

(g) Finance income and expense

Finance income comprises interest income on funds invested. Interest income is recognised as it accrues in profit or loss.

Finance expense comprises interest payable on borrowings calculated using the effective interest method, loan facility fees and unrealised fair value losses on embedded derivatives that are not closely related to their host liability contracts. All borrowing costs are recognised in profit or loss.

(h) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable based on taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised, using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised on initial recognition of an asset or liability which affects neither accounting nor taxable profit provided it is not recognised as part of a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities when they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that future taxable profits will be available against which the temporary differences can be utilised. The carrying values of deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(i) Earnings/(loss) per ordinary share

The group presents basic and diluted earnings/(loss) per share (“EPS”) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the company by the weighted average number of ordinary shares outstanding during the period.

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

(j) Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognised in profit or loss on a straight line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives for the current and comparative periods are as follows:

	Years
Fixtures and Fittings	3 – 10
Laboratory equipment	5

Residual values and useful lives of property, plant and equipment are reviewed and adjusted if appropriate at each reporting date.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within “other income” in profit or loss.

Subsequent costs are included in an asset’s carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the replaced item can be measured reliably. All other repair and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. As lessee, the group’s operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

(k) Intangible assets

Acquired in process research and development (“IPR&D”) and acquired patent and licence agreements are stated at cost less accumulated impairment losses. Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire the asset at the time of its acquisition or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs (IFRS 2: Share-based payment).

The acquired patent and licence agreements are being amortised to research and development costs in the income statement over their useful lives on a straight line basis. Estimated useful life is the lower of legal duration and economic useful life and has been estimated as five years. The acquired IPR&D will be amortised on a straight line basis over its estimated useful life which will commence upon generation of economic benefits relating to the acquired IPR&D.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(l) Impairment

The carrying values of the group's assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised in profit or loss if the carrying amount of an asset exceeds its estimated recoverable amount. The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use. Value in use is assessed by discounting future cash flows of the asset to its present value. Estimated cash flows are discounted using a pre-tax discount rate reflecting current market assessments of the time value of money and the risks specific to the asset.

(m) Trade and other receivables

Trade receivables, which generally have 30 to 90 day terms, are recognised initially at fair value and then carried at amortised cost less an allowance for any impairment. Impairment charges are expensed to the income statement.

(n) Cash and cash equivalents

Cash represents cash held at banks and available on demand. Cash equivalents are highly liquid investments (other than cash) that are readily convertible into known amounts of cash, typically cash deposits of more than one day, but less than three months. Cash and cash equivalents are recorded initially at fair value and then subsequently stated at amortised cost and are categorised as loans and receivables.

(o) Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents and trade and other payables. Non-derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Derivative financial instruments

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognised immediately in profit or loss.

(p) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(q) Government grants

Government grants received that compensate the group for the cost of an asset are recognised in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the group will comply with the conditions attaching to it. Such grants are recognised in the income statement on a systematic basis over the useful economic life of the asset.

Grants that compensate the group for expenses incurred are recognised in the income statement on a systematic basis in the same periods in which the expenses are incurred once the company has reasonable assurance the grant will be received.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(r) Segment reporting

A segment is a distinguishable component of the group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

The group's primary reporting segments comprise geographic segments relating to the origin of its revenues, as the group only operates in one business segment, the development of oral dosage forms of drugs that are poorly absorbed.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment.

(s) New and prospective accounting standards and interpretations

Effective 1 January 2008, the provisions of a new accounting standard, IFRIC 11, "*IFRS 2—Group and Treasury Shares Transactions*", (IFRIC 11) has been adopted in our company financial statements on a retrospective basis. The interpretation addresses how share-based payment arrangements that affect more than one company in a group are accounted for in each company's financial statements. IFRIC 11 provides that equity-settled awards of the parent, which are granted to employees of subsidiary companies, are accounted for as a capital contribution to the subsidiaries and recorded as an increase in the cost of investment in subsidiaries. The adoption of IFRIC 11 has resulted in certain items in the prior period company balance sheet being restated to conform to the current accounting treatment and presentations pursuant to IFRIC 11. Specifically, this resulted in an increase in investments in subsidiaries of €17,988 and a corresponding increase in shareholders' equity in the period ended 31 December 2007.

We have considered all EU endorsed IFRS standards, amendments to these standards and IFRIC interpretations that have been issued, but which are not yet effective, and have not been early adopted in these financial statements. The following provides a brief outline of the likely impact on future financial statements of relevant items. If applicable, they will be adopted in future financial statements.

- IFRS 8, "*Operating Segments*", (effective 1 January 2009). This standard will replace IAS 14, "*Segment Reporting*". This standard specifies how an entity should disclose information about its segments which enables users to evaluate the nature and financial effects of its business activities and the economic environments in which it operates. We will adopt IFRS 8 with effect from 1 January 2009, and will accordingly present financial information for segments whose operating activities are regularly reviewed by the chief operating decision maker in order to make decisions about allocating resources and assessing performance. The adoption of this standard will not impact our primary financial statements and we do not expect that it will have a material impact on our operating segment disclosures.
- Amendments to IFRS 1 and IAS 27 "*Cost of an Investment in a Subsidiary, Jointly-Controlled Entity or Associate*", (effective 1 January 2009). The objective of this amendment is to enhance the relevance, reliability and comparability of the information that a parent entity provides in its separate financial statements and in its consolidated financial statements for a group of entities under its control. We do not expect that the adoption of these amendments will have a material impact on our financial statements.
- Amendment to IFRS 2, "*Share-based Payment—Vesting Conditions and Cancellations*", (effective 1 January 2009). This amendment clarifies that vesting conditions comprise only service conditions and performance conditions. It also specifies the accounting treatment for a failure to meet a non-vesting condition. We do not expect that the adoption of this amendment will have a material impact on our financial statements.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(s) *New and prospective accounting standards and interpretations (continued)*

- Amendment to IAS 1, “*Presentation of Financial Statements—A Revised Presentation*”, (effective 1 January 2009). This amendment sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The revised standard aims to improve users' ability to analyse and compare information given in financial statements. The adoption of this amendment will have no recognition impact in our consolidated and company financial statements. It will, however, result in certain presentational changes in the primary financial statements.
- Amendment to IAS 23 “*Borrowing Costs*”, (effective 1 January 2009). The revised standard eliminates the option of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. We do not expect that the adoption of this amendment will have a material impact on our financial statements.
- IFRIC 13 “*Customer Loyalty Programmes*”, (effective for annual periods beginning on or after 1 July 2008). This amendment addresses how companies that grant their customers loyalty award credits (often called 'points') when buying goods or services should account for their obligation to provide free or discounted goods and services, if and when the customers redeem the points. We do not expect that the adoption of this interpretation will have a material impact on our financial statements.
- Amendments to IAS 32 “*Financial Instruments: Presentation*” and IAS 1 “*Puttable Financial Instruments and Obligations Arising on Liquidation*” (effective 1 January 2009). These amendments change the classification from liabilities to equity of (a) some puttable financial instruments and (b) some financial instruments that impose on the entity an obligation to deliver another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity. We do not expect that the adoption of these amendments will have a material impact on our financial statements.
- On 22 May 2008 the International Accounting Standards Board published the “*Improvements to International Financial Reporting Standards 2008*”, (generally effective 1 January 2009). Part 1 includes 24 amendments to IFRSs that result in accounting changes for presentation, recognition or measurement purposes. The Part 1 amendments include changes relating to the following standards: IFRS 5, IAS 1, IAS 16, IAS 19, IAS 20, IAS 23, IAS 27, IAS 28, IAS 29, IAS 31, IAS 36, IAS 38, IAS 39, IAS 40 and IAS 41. Part 2 includes 11 terminology or editorial amendments that are expected to have minimal effect. We do not expect that the adoption of these amendments will have a material impact on our financial statements.

3. Analysis of revenues and segment reporting

Business segment information

All of the group's operating results arise from the development of pharmaceutical products. Accordingly, the group only operates in one business segment. The group has reported all costs and revenues and attributed all assets and liabilities to that segment.

Geographical segment information

The group's area of operations outside of Ireland principally comprise of the United States. Geographical segment information is set forth below.

Merrion Pharmaceuticals plc

Notes (continued)

3. Analysis of revenues and segment reporting (continued)

Geographical segment information

	Year ended 31 December 2008			Year ended 31 December 2007		
	Ireland €	United States €	Total €	Ireland €	United States €	Total €
External revenue	1,339,939	-	1,339,939	469,233	-	469,233
Segment result						
Operating loss	(4,763,232)	(662,035)	(5,425,267)	(4,478,389)	(1,380,686)	(5,859,075)
Finance income/(expense)	341,792	21,149	362,941	(6,147,885)	(68,890)	(6,216,775)
Income tax	-	-	-	-	-	-
Loss for the year	(4,421,440)	(640,886)	(5,062,326)	(10,626,274)	(1,449,576)	(12,075,850)
Other segment information						
Depreciation and amortisation	546,812	1,297	548,109	411,756	3,206	414,962
Capital expenditure	367,675	1,260	368,935	190,065	2,765	192,830
Share-based compensation	587,950	-	587,950	211,281	-	211,281
Segment assets and liabilities						
Total assets	9,540,161	140,092	9,680,253	12,108,425	157,386	12,265,811
Total liabilities	(3,855,052)	(153,799)	(4,008,851)	(2,051,133)	(79,657)	(2,130,790)

Merrion Pharmaceuticals plc

Notes (continued)

4. Finance income

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Interest income	342,062	175,415
Net foreign exchange gain	21,149	-
Fair value adjustments on embedded derivatives:		
- convertible loan stock	-	262,859
- convertible preference shares	-	53,140
Total finance income	363,211	491,414

Interest income relates solely to interest earned on cash on deposit. During the year ended 31 December 2007, the group recognised fair value adjustments on embedded derivatives of €315,999 in aggregate, associated with its convertible loan stock and convertible preference shares. In conjunction with the company's IPO on 18 December 2007, the convertible loan stock and convertible preference shares were converted to ordinary shares.

5. Finance expense

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Interest on loans and borrowings	270	1,305
10% convertible loan stock interest	-	6,175,395
Interest and dividends on preference share capital	-	107,051
Net foreign exchange loss	-	68,890
Fair value adjustments on embedded derivatives		
- convertible preference shares	-	355,548
Total finance expense	270	6,708,189

During the year ended 31 December 2007, the group recognised interest of €6,175,395 on its convertible loan stock, interest of €107,051 on its preference shares and fair value adjustments on embedded derivatives of €355,548 associated with its convertible preference shares. In conjunction with the company's IPO on 18 December 2007, the convertible loan stock and convertible preference shares were converted to ordinary shares.

Merrion Pharmaceuticals plc

Notes (continued)

6. Payroll and related employee benefits

The aggregate payroll costs of employees, including executive directors, were as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
	€	€
Wages and salaries ⁽¹⁾	1,581,859	1,468,286
Contributions to defined contribution plans	111,344	101,283
Social welfare costs ⁽¹⁾	150,848	140,345
Equity settled share-based payment transactions ⁽²⁾	401,846	56,316
Total payroll costs	2,245,897	1,766,230

(1) The above excluded fees and other emoluments attributable to non-executive directors. Details of directors' emoluments are set forth in note 7 to the consolidated financial statements.

(2) The above excludes share-based compensation expense for the year ended 31 December 2008 attributable to non-executive directors of €186,104 (2007: €154,965).

The average number of employees, including executive directors, was as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
	Number	Number
Administration	5	4
Research and development	18	16
Average number of employees	23	20

At 31 December 2008, we had 23 employees (2007: 21).

There are no employees or executive directors in the parent company.

Merrion Pharmaceuticals plc

Notes (continued)

7. Statutory and other information

The loss before income tax has been arrived at after charging the following items:

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Directors' emoluments:		
Fees	207,333	50,000
Salaries and bonus	270,190	423,517
Pension contributions	20,545	25,221
Share-based compensation expense	254,175	154,965
Other emoluments and benefits in kind	2,953	2,993
Total directors' emoluments	755,196	656,696
Auditor's remuneration:		
Audit fees ⁽¹⁾	75,000	132,000
Audit related fees ⁽²⁾	-	433,480
Tax fees ⁽³⁾	15,520	15,520
Total auditor's remuneration	90,520	581,000
Amortisation of intangible assets	180,000	180,000
Depreciation of property, plant and equipment	368,109	234,962
Operating lease rentals	215,158	195,345
Grant amortisation	(14,322)	(14,333)

- (1) Audit services include financial statement audit work performed in respect of the consolidated financial statements, as well as work that generally only the independent auditor can reasonably be expected to provide, including comfort letters, statutory audits, and discussions surrounding the proper application of financial accounting and/or reporting standards.
- (2) Audit-related services are for assurance and related services that are traditionally performed by the independent auditor, including special procedures required to meet certain regulatory requirements.
- (3) Tax services include all services, except those services specifically related to the audit of financial statements, performed by the independent auditor's tax personnel; supporting other tax-related regulatory requirements; and tax compliance and reporting.

Merrion Pharmaceuticals plc

Notes (continued)

8. Income tax

No current tax expense/(benefit) arises in the current year or in the year ended 31 December 2007, due to taxable losses incurred which are available for offset against future taxable profits and losses brought forward from previous periods.

A reconciliation of the expected tax expense/(benefit), computed by applying the standard Irish tax rate to loss before income tax to the actual tax expense/(benefit), is as follows:

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Loss before income tax for the year	(5,062,326)	(12,075,850)
Standard rate of corporation tax in Ireland	12.5%	12.5%
Tax on loss for the year at Irish standard rate	(632,791)	(1,509,481)
<i>Effect of:</i>		
Non-deductible expenses	142,180	1,243,214
Depreciation in excess of capital allowances	12,290	1,168
Interest income taxed at 25%	40,765	27,234
Unutilised losses carried forward to future periods	437,556	237,865
Income tax expense/(benefit) on loss for the year	-	-

At 31 December 2008, the Irish operations had operating loss carryforwards for income tax purposes that may be carried forward indefinitely available to offset against future taxable income, if any, of approximately €10,140,226, (2007: €7,046,576). At 31 December 2008, the US operations had net operating loss (“NOL”) carry forwards for federal and state tax purposes of €58,921, (2007: €47,806).

The deferred tax assets relating to net operating losses have not been recognised to the extent that it is considered unlikely that a benefit will be received in the future given the history of operating losses incurred. In total, the group has unrecognised deferred tax assets at 31 December 2008 of €2,856,599, (2007: €2,257,254).

Merrion Pharmaceuticals plc

Notes (continued)

9. Net loss per share

Basic earnings/(loss) per share is computed by dividing the net income/(loss) for the year available to ordinary shareholders by the sum of the weighted-average number of ordinary shares outstanding during the year. Diluted earnings/(loss) per share is computed by dividing the net income/(loss) for the year by the weighted-average number of ordinary shares outstanding and, when dilutive, adjusted for the effect of all dilutive potential ordinary shares, including share options, restricted shares and contingently issuable shares, such as convertible loan stock and convertible preference share, on an as-if-converted basis.

Basic and diluted net loss per share for the group is calculated as follows:

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Numerator (net loss)		
Basic and diluted net loss for the year attributable to ordinary shareholders	5,062,326	12,075,850
	Year ended 31 December 2008 Shares	Year ended 31 December 2007 Shares
Denominator (weighted average number of ordinary shares)		
Weighted average number of ordinary shares	16,618,808	7,542,967
	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Basic and diluted loss per share		
Basic and diluted net loss per ordinary share	(0.30)	(1.60)

For the years ended 31 December 2008 and 2007, there was no difference in the weighted average number of ordinary shares used for the basic and diluted net loss per ordinary share computation, as the effect of all potentially dilutive shares are anti-dilutive due to the existence of net losses from inception of the company. At 31 December 2008, there were share options outstanding of 991,631 (2007: share options outstanding of 650,021, convertible loan stock of 4,982,822 and convertible preference shares of 318,251) which could potentially have a dilutive impact in the future, but which were anti-dilutive in 2008 and 2007.

Merrion Pharmaceuticals plc

Notes (continued)

10. Property, plant and equipment

	Fixtures and fittings €	Laboratory equipment €	Total €
31 December 2008			
<i>Cost</i>			
Balance at 1 January 2008	97,019	1,701,473	1,798,492
Additions	53,766	315,169	368,935
Balance at 31 December 2008	150,785	2,016,642	2,167,427
<i>Accumulated depreciation</i>			
Balance at 1 January 2008	63,038	948,674	1,011,712
Charge for the year	16,247	351,862	368,109
Balance at 31 December 2008	79,285	1,300,536	1,379,821
<i>Net book value</i>			
At 31 December 2008	71,500	716,106	787,606
31 December 2007			
<i>Cost</i>			
Balance at 1 January 2007	75,890	1,529,772	1,605,662
Additions	21,129	171,701	192,830
Balance at 31 December 2007	97,019	1,701,473	1,798,492
<i>Accumulated depreciation</i>			
Balance at 1 January 2007	47,981	728,769	776,750
Charge for the year	15,057	219,905	234,962
Balance at 31 December 2007	63,038	948,674	1,011,712
<i>Net book value</i>			
At 31 December 2007	33,981	752,799	786,780

Merrion Pharmaceuticals plc

Notes (continued)

11. Intangible assets

	31 December 2008	31 December 2007
	€	€
<i>Cost</i>		
At beginning and end of year	900,000	900,000
<i>Accumulated amortisation</i>		
Balance at the beginning of the year	720,000	540,000
Amortisation for the year	180,000	180,000
Balance at the end of the year	900,000	720,000
<i>Net book value</i>		
At the end of the year	-	180,000

On 16 February 2004, the group acquired four platform drug delivery technologies, together with certain equipment used solely in the research and development of those technologies from a shareholder pharmaceutical company, Elan Corporation, plc (“Elan”). Part of one of the drug delivery platforms was licensed from Elan as opposed to being acquired outright. This is an exclusive worldwide license which lasts for the longer of 15 years from the completion of the contract or the term of the patent. This transaction was accounted for as an asset purchase and as a result €900,000 of the purchase consideration was allocated to in-process research and development. As at 31 December 2008, the acquired intangible asset has been amortised in full over its expected useful life of five years. The amortisation charge has been recognised within research and development expenses in the income statement.

Part of the purchase contract provides that the group has an obligation to pay Elan royalties of 10%, less applicable costs, in connection with revenue attributable to the patents purchased or licensed under the agreement. These payments will be made until the later of (a) the expiration of the relevant patent or (b) 15 years from the completion of the purchase contract. See note 22 to the consolidated financial statements for details of amounts attributable to Elan for the year ended 31 December 2008.

In the event the company disposes of any of the assets acquired in the period to 31 December 2010, the company is required to pay Elan a relevant percentage of the net disposal proceeds received. The percentage is on a reducing basis, with 50% of the net proceeds payable in 2004 declining to 5% of the net proceeds payable in 2010. The company had not disposed of any of the acquired equipment or drug delivery technologies at 31 December 2008.

Merrion Pharmaceuticals plc

Notes (continued)

12. Trade and other receivables

	31 December 2008	31 December 2007
	€	€
Trade receivables	385,735	3,382
Prepayments	180,073	196,928
Other receivables	105,801	68,718
Value added tax receivable	80,953	160,304
Total trade and other receivables	752,562	429,332

All amounts fall due within one year.

At 31 December 2008 and 2007 €Nil of our trade receivables balance was past due but not impaired.

Our provision for doubtful debts was €Nil at both 31 December 2008 and 2007.

The following customers account for more than 10% of our trade receivables at 31 December 2008 and 2007:

	31 December 2008	31 December 2007
Novo Nordisk A/S	97%	2%
Gloucester Pharmaceuticals Inc	-%	98%

13. Cash and cash equivalents

	31 December 2008	31 December 2007
	€	€
Bank balances	312,423	373,025
Call deposits	7,827,662	10,496,674
Total cash and cash equivalents	8,140,085	10,869,699

The group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 18 to the consolidated financial statements.

Merrion Pharmaceuticals plc

Notes (continued)

14. Deferred income

Non- current	31 December 2008 €	31 December 2007 €
Deferred operating income	1,686,241	-
Government grant	-	11,485
Total deferred income - non-current	1,686,241	11,485

Current	31 December 2008 €	31 December 2007 €
Deferred operating income	718,087	119,074
Government grant	11,485	14,322
Total deferred income - current	729,572	133,396

15. Accrued and other payables

Current	31 December 2008 €	31 December 2007 €
Accrued liabilities	608,986	806,354
Accrued social welfare costs	65,720	5,095
Amounts owed to related parties	254,806	32,971
Total accrued and other payables	929,512	844,420

Amounts owed to related parties are further explained in note 22 to the consolidated financial statements.

Merrion Pharmaceuticals plc

Notes (continued)

16. Share capital

	31 December 2008	31 December 2007
	€	€
<i>Authorised</i>		
100,000,000 ordinary shares of €0.01 each	1,000,000	1,000,000
10,000,000 convertible preference shares of €0.01 each	100,000	100,000
	1,100,000	1,100,000
<i>Issued, called up and fully paid</i>		
16,659,157 (31 December 2007: 16,583,768) ordinary shares at €0.01 each	166,592	165,838

On 10 April 2006, Merrion Pharmaceuticals Limited became the holding company of the group headed up by Merrion Pharmaceuticals Inc. The re-organisation was enacted by a share for share exchange. On that date Merrion Pharmaceuticals Limited acquired the entire issued share capital of Merrion Pharmaceuticals Inc. amounting to 15,047,800 ordinary shares (before sub-division of shares on 7 September 2007) of \$0.000001 par value each and 750,000 convertible preference shares in the capital of Merrion Pharmaceuticals Inc. and, in consideration, Merrion Pharmaceuticals Limited issued one ordinary share of €0.01 credited as paid up for one ordinary share of \$0.0000001 par value in the capital of Merrion Pharmaceuticals Inc. and 750,000 convertible preference shares. The value of the shares in Merrion Pharmaceuticals Inc was €4,000,000. The difference between the carrying value of the assets and liabilities of the company and the fair value of the company was recorded as a reverse acquisition reserve of €51,471. On 17 August 2007, the board of directors of the company approved a reclassification of the company's share capital, giving shareholders 1 share each for every 2.3 shares held. This share reclassification was approved by the shareholders and became effective on 7 September 2007. On 28 August 2007, Merrion Pharmaceuticals Limited was renamed Merrion Pharmaceuticals Holdings Limited.

Merrion Pharmaceuticals plc was incorporated on 19 July 2007 with nominal share capital of 7 ordinary shares, in contemplation of an initial public offering of the business.

On 7 September 2007, Merrion Pharmaceuticals plc became the new parent holding company. The outstanding shares of Merrion Pharmaceuticals Holdings Limited were exchanged for equivalent shares in Merrion Pharmaceuticals plc through the issuance of 7,230,434 ordinary shares of €0.01 par value each and 750,000 convertible preference shares of €1.00 par value each.

On 18 December 2007 the company's shares commenced trading on the IEX. On that date, the following additional shares were issued as follows:

- 18,968 ordinary shares were issued to the third party pharmaceutical company to satisfy their entitlement at that date,
- 794,165 ordinary shares were issued in satisfaction of an existing entitlement to subscribe for 5% of the outstanding ordinary shares of the company for cash consideration of €789,474,
- 956,504 ordinary shares were issued at par to certain directors and management in satisfaction of other existing entitlements to subscribe for ordinary shares,
- 336,700 ordinary Shares were issued to the holders of the 750,000 Series A preference shares of €1.00 in satisfaction of the entitlement of the holders of the A preference shares to receive ordinary shares on conversion,

Merrion Pharmaceuticals plc

Notes (continued)

16. Share capital (continued)

- 5,271,680 ordinary shares were issued to the holders of the convertible loan stock in satisfaction of the entitlement of the holders of the convertible loan Stock to receive ordinary shares on conversion,
- 1,975,309 ordinary shares were issued for cash at a price of €4.05 per share.

Costs incurred in connection with the admission to IEX amounted to €1,848,622.

During the year ended 31 December 2008, a total of 75,390 (2007: 375,000) ordinary shares were issued to certain employees and directors in conjunction with the exercise of their vested share option awards, in line with the terms and conditions set out in note 17 to the consolidated financial statements.

17. Share-based payments

On 17 February 2005, the company adopted an equity-settled Share Option Plan (“the Plan”) pursuant to which the Compensation Committee of the board of directors may grant options to employees, non-employees and senior executives of the company or its subsidiaries for the purchase of ordinary shares. Each grant of an option under the Plan will be evidenced by a share option agreement between the optionee and the company. The exercise price and vesting period are determined by the board of directors and are specified in each share option agreement.

An aggregate of 282,608 ordinary shares were reserved for issuance under the Plan. No share options can be granted after 8 August 2016. On 15 March 2007, the number of ordinary shares reserved for issuance under the plan was increased by 1,086,956.

Total share options outstanding at the balance sheet date are summarised as follows:

	Number of share options	Weighted average exercise price	Weighted average fair value	Weighted average remaining contractual life
Outstanding at 1 January 2007	277,091	€0.11	€1.26	8.3 years
Granted	375,000	€4.05	€1.98	7.2 years
Cancelled	(2,070)	€0.27	€0.41	6.1 years
Outstanding at 31 December 2007	650,021	€2.38	€1.57	7.3 years
Granted	467,000	€2.58	€1.31	6.6 years
Exercised	(75,390)	€0.14	€1.89	-
Cancelled	(50,000)	€4.05	€1.97	6.0 years
Outstanding at 31 December 2008	991,631	€2.56	€1.49	6.46 years

The number of share options exercisable at 31 December 2008 was 298,900 (2007: 218,587).

At 31 December 2008, total unrecognised share-based compensation expense relating to unvested share options outstanding of 692,731 (2007: 431,434) amounted to €32,250 (2007: €13,300), which the company expects to recognise over a weighted average vesting period of 3.25 years (2007: 2.73 years).

Merrion Pharmaceuticals plc

Notes (continued)

17. Share-based payments (continued)

Of the share options granted in the periods above, no share options were granted to non-employees in the years ended 31 December 2008 and 2007.

Total share-based compensation expense was recognised in the following line items in the consolidated income statement:

	Year ended 31 December 2008	Year ended 31 December 2007
	€	€
Administrative expenses	315,557	195,475
Research and development expenses	272,393	15,806
Total share-based compensation expense	587,950	211,281

Employee share options typically vest annually over a period of three years from date of grant and expire 7 to 10 years from date of grant. However, options that are currently outstanding provide that in the event of a change of control resulting in a change in beneficial ownership of at least a majority of the company's then existing voting ordinary shares, all of the options that are unvested and unexercisable become immediately vested and exercisable as of a date prior to the transaction determined by the Board of Directors. Additionally, such share options typically provide that upon the death or disability of the optionee or upon the termination of such optionee's employment with the company without cause, all of the options that are unvested or unexercisable become immediately vested and exercisable. The maximum contractual term of options outstanding at 31 December 2008 is 9 years. The fair value of employee options was calculated using a binomial option-pricing model in accordance with IFRS 2.

The fair value of the share option awards was calculated using a binomial option-pricing model under the following assumptions:

	31 December 2008		31 December 2007	
Grant date	20 October 2008	9 July 2008	19 May 2008	12 December 2007
Date of earliest exercise	11 July 2009	9 July 2009	18 May 2009	12 December 2008
Date of expiration	19 October 2015	9 July 2015	18 May 2015	12 December 2014
Market price	€2.50	€2.50	€3.58	€4.05
Fair value	€1.00	€1.41	€1.95	€1.97
<i>Assumptions</i>				
Expected volatility ⁽¹⁾	60%	60%	60%	50%
Dividend yield	Nil	Nil	Nil	Nil
Risk-free interest rate ⁽²⁾	3.7% - 4.4%	3.7% - 4.4%	3.7% - 4.4%	4.1% - 4.7%
Expected term (years) ⁽³⁾	4.7 years	4.7 years	4.7 years	6 years

⁽¹⁾ The expected volatility is based on the volatility of similar companies in their early years.

⁽²⁾ The risk-free rate is based on a zero coupon Eurozone Treasury gilt yield rate at the date of grant.

⁽³⁾ Two thirds of the overall term to expiry for employees, and contractual term for non-employees.

Merrion Pharmaceuticals plc

Notes (continued)

18. Financial instruments and risk management

The group's operations expose it to various financial risks in the ordinary course of business that include credit risk, liquidity risk, foreign currency risk and interest rate risk.

The group manages its financial risk exposures on a group wide basis and seeks to reduce the exposure of significant risks through a process of controlling, monitoring and reporting. Planning and budgetary processes increase the opportunity for early warnings of financial risk. Monthly financial reporting aids the identification of risk areas by management. Risk management is overseen by the board of directors, which oversees activities of management with regard to the financial risks faced by the group. The group's approach to the management of these financial risks is further described for each risk area below.

(a) Financial assets and liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced liquidation or sale. The carrying value and fair value of the group's financial assets and financial liabilities by category were as follows:

	Loans and receivables	Liabilities at amortised cost	Total carrying value	Fair value
	€	€	€	€
31 December 2008				
Cash and cash equivalents	8,140,085		8,140,085	8,140,085
Trade receivables	385,735		385,735	385,735
Other receivables	105,801		105,801	105,801
Value added tax receivable	80,953		80,953	80,953
Trade payables		(663,526)	(663,526)	(663,526)
Accrued liabilities		(608,986)	(608,986)	(608,986)
Accrued social welfare		(65,720)	(65,720)	(65,720)
Amounts owing to related parties		(254,806)	(254,806)	(254,806)
At 31 December 2008	8,712,574	(1,593,038)	7,119,536	7,119,536
31 December 2007				
Cash and cash equivalents	10,869,699		10,869,699	10,869,699
Trade receivables	3,382		3,382	3,382
Other receivables	68,718		68,718	68,718
Value added tax receivable	160,304		160,304	160,304
Trade payables		(1,141,489)	(1,141,489)	(1,141,489)
Accrued liabilities		(806,354)	(806,354)	(806,354)
Accrued social welfare		(5,095)	(5,095)	(5,095)
Amounts owing to related parties		(32,971)	(32,971)	(32,971)
At 31 December 2007	11,102,103	(1,985,909)	9,116,194	9,116,194

Merrion Pharmaceuticals plc

Notes (continued)

18. Financial instruments and risk management (continued)

(b) Estimation of fair values

Set out below are the major methods and assumptions used in estimating the fair values of the financial assets and liabilities. There is no material difference between the fair value of these assets and liabilities and their carrying amounts.

Cash and cash equivalent including short term deposits

The carrying value of cash and cash equivalents at amortised cost, all of which have a remaining maturity of less than three months, has been determined to approximate its fair value.

Trade and other receivables and trade payables

The nominal amount of all trade and other receivables and trade payables less impairment provisions, where necessary, is deemed to reflect fair value.

Accrued liabilities, accrued social welfare, amounts owing to related parties

The amounts payable are expected to be settled within one year and so the carrying value is deemed to reflect fair value.

(c) Credit risk

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet contractual obligations, and arises principally from the group's cash and cash equivalents and its receivables from customers.

The current assets of the group consist primarily of cash and cash equivalents. The group limits its exposure to credit risk associated with cash and cash equivalents by only placing funds on deposit with financial institutions approved by the board of directors. Approved institutions have an acceptable rating of A or above from either Standard & Poors or Moodys and the treasury policy of the group details the maximum level of funds that can be placed in any one institution. Given these policies, management does not expect any counterparty to fail to meet its obligations. The group currently holds cash and cash equivalents in three different financial institutions.

The group's exposure to risk attached to trade receivables is influenced by the size and profitability of each customer. Revenue recognised during the financial year ended 31 December 2008 is attributable to three customers. As set forth in note 12 to the consolidated financial statements 97% (2007: 98%) of the total revenue earned during the year ended 31 December 2008 was attributable to services performed for a single customer. At 31 December 2008 and 2007 €Nil of our trade receivables balance was past due but not impaired. Our provision for doubtful debts was €Nil at both 31 December 2008 and 2007.

The credit risk associated with providing services to a small number of customers is controlled by only entering into agreements once partner agreements have been considered and approved by management and the board of directors, ensuring that the group only enters into service agreements with credit worthy parties. Current year financial statements, recommendations and references are all used for rating the credit worthiness of a potential customer. For this reason and the nature of the partner agreements, the group has a small customer base. Projects, undertaken by the group are considered long term.

Invoices are raised and issued at the completion of agreed programmes throughout the partner agreement to ensure that credit risk is minimised. Unpaid balances are regularly monitored for impairment and to date bad debts have not been an issue.

Merrion Pharmaceuticals plc

Notes (continued)

18. Financial instruments and risk management (continued)

(d) Liquidity risk

Liquidity risk is the risk that the group will not be able to meet its financial obligations as they fall due. The group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the group's reputation.

The group has a limited operating history and has not yet commercialised any products or generated any product revenue. As at 31 December 2008, the group had an accumulated deficit of €28,733,110 (2007: €23,813,217). The group has incurred losses in each year since its inception in December 2003. Net losses were €5,062,326 (2007: €12,075,850) for the year ended 31 December 2008. Losses in the year ended 31 December 2007 arose principally in respect of non-cash charges of €6,637,994.

The group expects to continue reporting operating losses in the short term, as it continues research activities and conducts development of, and seeks regulatory approvals for, initial drug candidates, and commercialises any approved drugs. However, the group expects to generate increasing revenues following the signing of development agreements in December 2008 and January 2009. The group will seek new partnerships during 2009.

The group has financed its operations and internal growth principally through private placements of equity, and to a significantly lesser extent through revenues under service arrangements with pharmaceutical companies. The group manages and maintains expected future operating costs in order to ensure that sufficient medium term funding is available.

The following is an analysis of the maturity of contractual undiscounted cash flows relating to financial liabilities and operating leases at the balance sheet date:

	Total carrying value €	Total contractual cash flows €	Less than 1 year €	Between 1-2 years €	Between 2-5 years €	More than 5 years €
31 December 2008						
<i>Non-derivative financial liabilities</i>						
Trade payables	663,526	663,526	663,526	-	-	-
Amounts owed to related parties	254,806	254,806	254,806	-	-	-
Accrued liabilities	608,986	608,986	608,986	-	-	-
Social welfare	65,720	65,720	65,720	-	-	-
Obligations under operating leases	142,348	142,348	48,614	24,996	68,738	-
At 31 December 2008	1,735,386	1,735,386	1,641,652	24,996	68,738	-
31 December 2007						
<i>Non-derivative financial liabilities</i>						
Trade payables	1,141,489	1,141,489	-	-	-	-
Amounts owed to related parties	32,971	32,971	-	-	-	-
Accrued liabilities	806,354	806,354	-	-	-	-
Social welfare	5,095	5,095	-	-	-	-
Obligations under operating leases	191,741	191,741	191,741	38,060	74,988	18,746
At 31 December 2007	2,177,650	2,177,650	191,741	38,060	74,988	18,746

Merrion Pharmaceuticals plc

Notes (continued)

18. Financial instruments and risk management (continued)

(e) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Foreign currency risk

The Euro is the primary currency in which the group's business transactions are conducted and the Euro is used as the presentation currency of the group for financial reporting. A portion of the business transactions of the group is carried out in the United States and the United Kingdom. At 31 December 2008, 35% and 3% (2007: 10% and 1%) of the trade payables of the group were denominated in US dollars and GBP respectively.

During the year ended 31 December 2008, the group entered into partner agreements where terms and conditions are denominated in US dollars. As a result, all future revenue associated with these agreements, will be translated at the rate prevailing on the date of transaction. A strengthening of the Euro against the US dollar could therefore reduce earnings. Consequently, fluctuations in the rate of exchange between the US dollar, Sterling and the Euro will affect period to period comparisons of reported results.

The group's operations are predominantly located in the Eurozone, consequently, the group has only limited exposure to exchange rate risk related to the translation of foreign operations. Given the low level of exposure, the group policy is not to hedge this balance sheet risk.

A 10 percent strengthening of the Euro against the following currencies, based on outstanding financial assets and liabilities at 31 December 2008 and 2007, would have increased/(decreased) net loss after tax by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

	31 December 2008	31 December 2007
	Impact on net loss	Impact on net loss
	€	€
US dollars	(16,752)	(4,805)
Sterling	(2,155)	(1,665)

A 10 percent weakening of the Euro against the above currencies would have an equal but opposite effect on net loss after tax to the amounts shown above, on the basis that all other variables remain constant.

Interest rate risk

At 31 December 2008, the group had cash and cash equivalents of €8,140,085 (2007: €10,869,699), a significant (96%) amount (2007: 81%) of which was on deposit in variable rate Euro deposit accounts, which earned deposit interest income of €42,062 (2007: €175,415) during the year ended 31 December 2008. The availability of these funds varies between one month and five months notice.

Variable interest rates on cash and cash equivalents are generally based on the appropriate Euro Interbank Offered Rate or bank rates dependent on principal amounts on deposit.

The group had no variable rate liabilities during the years ended 31 December 2008 and 2007.

Merrion Pharmaceuticals plc

Notes (continued)

18. Financial instruments and risk management (continued)

(e) Market risk (continued)

Interest rate risk (continued)

A 10 percent increase in market rates of interest available on Euro deposit accounts would have reduced the net loss after tax earned by the group during the years ended 31 December 2008 and 2007 by €34,422 and €40,683 respectively. A 10% decrease in market rates of interest would have had the equal but opposite effect on net loss after tax in 2008 and 2007. This analysis assumes that all other variables remain constant.

Other market price risk

Other market price risk considers the exposure of the fair value or future cash flows of a financial instrument to fluctuation because of changes in market prices. The group has been exposed to market price risk on embedded derivatives associated with the issue of convertible loan notes and preference shares during the 2006 financial year, which resulted in a net charge to the income statement of €39,549 in the year ended 31 December 2007. Following the conversion of these loan agreements and preference shares to ordinary shares during 2007, there was no such charge during the 2008 financial year and the related embedded derivative was eliminated.

Capital management

The primary objective of the group when managing capital is to sustain future development of the business. The board of directors approves and monitors any changes to the group's capital structure. The board seeks to maintain a balance between expected future costs and cash available to the group. Members of the management team continue to research the possibility of future funding from investors in the US and Europe, though no decisions have yet been made. The company did not have any externally imposed capital requirements at 31 December 2008 and 2007.

19. Operating leases

Non-cancellable operating lease rentals are payable as follows:

Non- current	31 December 2008	31 December 2007
	€	€
Within one year	48,614	191,741
Between one and five years	93,734	113,048
Thereafter	-	18,746
Total minimum rental payments	142,348	323,535

The group leases its facility in Wilmington, NC, USA. This is a twelve month lease and it expires on 30 November 2009. The group has an equipment lease agreement that is due to expire in September 2013 that covers much of the group's research and development equipment. The group pays all executory costs such as maintenance and insurance. The group paid €15,158 in leasing expenses for the fiscal year ended 31 December 2008 and €230,496 for the year ended 31 December 2007.

20. Commitments and contingencies

The group is not party to any capital commitments, litigation or other legal proceedings that the group believes could reasonably be expected to have a material adverse effect on the group's business, consolidated financial position, results of operations or cash flow.

Merrion Pharmaceuticals plc

Notes (continued)

21. Reserves

	Share capital		Share premium €	Ordinary shares to be issued		Reverse acquisition reserve €	Share option reserve €	Retained losses €	Total €
	Shares Number	Amount €		Shares Number	Amount €				
At 31 December 2006	7,230,434	166,300	3,849,522	23,983	-	(51,471)	108,055	(11,737,367)	(7,664,961)
<i>Effect of group reorganisation:</i>									
Transfer of Merrion Pharmaceuticals Holdings Limited shares to Merrion Pharmaceuticals plc	(7,230,434)	(166,300)	(3,849,522)	(23,983)	-	51,471	(108,055)		(4,072,406)
Shares of Merrion Pharmaceuticals plc issued to former Merrion Pharmaceuticals Holdings Limited shareholders	7,230,434	72,304	29,210,954	23,983	-	(25,318,907)	108,055		4,072,406
	7,230,434	72,304	29,210,954	23,983	-	(25,318,907)	108,055	(11,737,367)	(7,664,961)
<i>Recognised income and expense:</i>									
Net loss	-	-	-	-	-	-	-	(12,075,850)	(12,075,850)
Total recognised income and expense	-	-	-	-	-	-	-	-	(12,075,850)
Shares issued in Merrion Pharmaceuticals plc on date of incorporation	7	-	-	-	-	-	-	-	-
Shares issued on exercise of option by shareholders	794,165	7,942	781,532	-	-	-	-	-	789,474
Share issue costs	-	-	(1,848,622)	-	-	-	-	-	(1,848,622)
Issue of ordinary shares in Initial Public Offering	1,975,309	19,753	7,980,248	-	-	-	-	-	8,000,001
Issue of ordinary shares on conversion of Series A preference shares	336,700	3,367	1,360,268	-	-	-	-	-	1,363,635
Restricted shares issued to employees at par value	956,504	9,565	-	(23,983)	-	-	-	-	9,565
Shares issued to third party pharmaceutical company	18,968	190	-	-	-	-	-	-	190
Shares issued in lieu of convertible loan notes	5,271,681	52,717	21,297,591	-	-	-	-	-	21,350,308
Share-based compensation expense	-	-	-	-	-	-	211,281	-	211,281
At 31 December 2007	16,583,768	165,838	58,781,971	-	-	(25,318,907)	319,336	(23,813,217)	10,135,021

Merrion Pharmaceuticals plc

Notes (continued)

21. Reserves (continued)

	Share capital		Share premium €	Reverse acquisition reserve €	Share option reserve €	Retained loss €	Total €
	Shares Number	Amount €					
At 31 December 2007	16,583,768	165,838	58,781,971	(25,318,907)	319,336	(23,813,217)	10,135,021
<i>Recognised income and expense:</i>							
Net loss	-	-	-	-	-	(5,062,326)	(5,062,326)
Total recognised income and expense	-	-	-	-	-	-	(5,062,326)
Share options exercised	75,389	754	10,003	-	-	-	10,757
Share-based compensation expense	-	-	-	-	587,950	-	587,950
Transfer of exercised and expired share-based awards	-	-	-	-	(142,433)	142,433	-
At 31 December 2008	16,659,157	166,592	58,791,974	(25,318,907)	764,853	(28,733,110)	5,671,402

Merrion Pharmaceuticals plc

Notes (continued)

22. Related parties

Mr. Patrick Wall, a former director of Merrion, is a partner in the accounting firm, PricewaterhouseCoopers, ("PwC"). The group retains PwC to provide tax and accounting advice. In the fiscal years ended 31 December 2008 and 31 December 2007, the group paid PwC fees of €25,410 and €40,648 respectively. Mr. Patrick Wall does not provide services to the company in his capacity as a partner in PwC. At 31 December 2008, there were no amounts payable to PwC (31 December 2007: €25,410).

As set forth in note 11 to the consolidated financial statements, the group has an obligation to pay Elan royalties of 10% less applicable costs, in connection with revenue attributable to the patents previously purchased from Elan. As at 31 December 2008, €15,564 (2007: €Nil) was payable to Elan in this respect.

On 23 December 2003, the group entered into an equipment lease agreement with Elan pursuant to which it leases certain laboratory equipment from Elan for a rental fee of €2,083 a month for a period of four years and nine months from the date of the agreement. This agreement was extended for an additional five years on 29 January 2007, and now expires on 31 December 2013. At 31 December 2008, €5,051 was payable to Elan in relation to leasing costs (31 December 2007: €7,561).

The total compensation of our key management personnel, defined as our current and former directors and executive officers, for the periods presented was as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
	€	€
Salaries	813,358	664,164
Bonus	146,355	119,345
Other benefits	12,190	10,634
Pension benefits	43,649	47,119
Share-based compensation expense	302,796	13,700
Total key management personnel compensation	1,318,348	854,962

The share-based payment amounts disclosed above represents the share-based compensation expense recognised in the income statement in the years ended 31 December 2008 and 2007 attributable to key management personnel.

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company balance sheet

a) Investment in subsidiaries

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Cost		
Balance at beginning of year/date of incorporation	29,545,827	-
Share-based compensation	401,846	217,988
Investment by way of share for share exchange	-	29,327,839
Balance at end of year	29,947,673	29,545,827

Share-based compensation represents additional capital contributions made to our subsidiaries to reflect the amounts expensed by these subsidiaries for share-based payment awards granted to subsidiary employees.

Merrion Pharmaceuticals plc was incorporated on 19 July 2007 with nominal share capital in contemplation of an initial public offering of the business. On 7 September 2007, Merrion Pharmaceuticals plc became the new parent holding company. The outstanding shares of Merrion Pharmaceuticals Holdings Limited, the predecessor parent company were exchanged for equivalent shares in Merrion Pharmaceuticals plc. On 28 August 2007, Merrion Pharmaceuticals Limited was renamed Merrion Pharmaceuticals Holdings Limited. The introduction of a new holding company was effected by Merrion Pharmaceuticals plc entering into an agreement with the shareholders of Merrion Pharmaceuticals plc to transfer the entire issued share capital of Merrion Pharmaceuticals Holdings Limited to Merrion Pharmaceuticals plc. 7,230,434 ordinary shares and 750,000 convertible preference shares were transferred to the shareholders of Merrion Pharmaceuticals Holdings Limited in consideration of the transfer to Merrion Pharmaceuticals plc of their respective holdings of ordinary and preference shares in Merrion Pharmaceuticals Holdings Limited. Therefore the company became the legal parent of Merrion Pharmaceuticals Holdings Limited at that time.

In the opinion of the directors, the investments in the subsidiary undertakings are valued at least at the amounts at which they are stated in the balance sheet. Details of subsidiaries are set out in note 23h to the company balance sheet.

b) Loans and receivables from subsidiaries

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Amounts due from subsidiary undertakings	9,920,279	9,920,279

All amounts due from subsidiary undertakings are interest free and repayable on demand.

c) Cash and cash equivalents

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Cash and cash equivalents	9,966	-

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company balance sheet (continued)

d) Amounts due to subsidiaries

	Year ended 31 December 2008 €	Year ended 31 December 2007 €
Amounts due to subsidiary undertakings	2,444,979	2,344,502

Amounts due to subsidiary undertakings are interest free and repayable on demand.

e) Share capital

	31 December 2008 €	31 December 2007 €
<i>Authorised</i>		
100,000,000 ordinary shares of €0.01 each	1,000,000	1,000,000
10,000,000 convertible preference shares of €0.01 each	100,000	100,000
	1,100,000	1,100,000
<i>Issued, called up and fully paid</i>		
16,659,157 (31 December 2007: 16,583,768) ordinary shares at €0.01 each	166,592	165,838

Details on share movements are set out in note 16 to the consolidated financial statements.

f) Financial instruments

Financial instruments in the company primarily take the form of loans to and from subsidiary undertakings.

Amounts due to or from subsidiary undertakings in the form of intercompany loans are interest free and are repayable upon demand. These inter-company balances are eliminated in the group consolidation.

The Euro is the functional and presentation currency of the company's balance sheet and all transactions entered into by the company are Euro denominated. As such, the company does not have any significant foreign currency risk.

The credit risk associated with the company's financial assets principally relates to the credit risk of the group as a whole, which is not rated by an external rating agency.

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company balance sheet (continued)

g) Reserves

	Share capital Shares Number	Share capital Amount €	Share premium €	Share option reserve €	Retained losses €	Total €
Shares issued on incorporation	7	-	-	-	-	-
<i>Recognised income and expense:</i>						
Net loss	-	-	-	-	(22,145,541)	(22,145,541)
Total recognised income and expense	-	-	-	-	-	(22,145,541)
Shares issued to former Merrion Pharmaceuticals Holdings Limited shareholders	7,230,434	72,304	29,210,954	108,055	-	29,391,313
Shares issued on exercise of option by shareholders	794,165	7,942	781,532	-	-	789,474
Share issue costs	-	-	(1,848,622)	-	-	(1,848,622)
Issue of ordinary shares in Initial Public Offering	1,975,309	19,753	7,980,248	-	-	8,000,001
Issue of ordinary shares on conversion of Series A preference shares	336,700	3,367	1,360,268	-	-	1,363,635
Restricted shares issued to employees at par value	956,504	9,565	-	-	-	9,565
Shares issued to third party pharmaceutical company	18,968	190	-	-	-	190
Shares issued in lieu of convertible loan notes	5,271,681	52,717	21,297,591	-	-	21,350,308
Share-based compensation expense	-	-	-	211,281	-	211,281
Balance at 31 December 2007	16,583,768	165,838	58,781,971	319,336	(22,145,541)	37,121,604
<i>Recognised income and expense:</i>						
Net loss	-	-	-	-	(287,372)	(287,372)
Total recognised income and expense	-	-	-	-	-	(287,372)
Share options exercised	75,389	754	10,003	-	-	10,757
Share-based compensation expense	-	-	-	587,950	-	587,950
Transfer of exercised and expired share-based awards	-	-	-	(142,433)	142,433	-
Balance at 31 December 2008	16,659,157	166,592	58,791,974	764,853	(22,290,480)	37,432,939

Merrion Pharmaceuticals plc

Notes (continued)

23 Notes to the company balance sheet (continued)

h) Principal subsidiary undertakings

Name	Country of incorporation	Proportion held by group	Registered office
Merrion Pharmaceuticals Holdings Limited	Ireland	100%	Third Floor Biotechnology Building Trinity College Dublin Ireland
Merrion Pharmaceuticals Ireland Limited	Ireland	100%	Third Floor Biotechnology Building Trinity College Dublin Ireland
Merrion Pharmaceuticals LLC	USA	100%	219 Racine Drive Suite D Wilmington North Carolina USA
Merrion Research I Limited	Ireland	100%	Third Floor Biotechnology Building Trinity College Dublin Ireland
Merrion Research II Limited	Ireland	100%	Third Floor Biotechnology Building Trinity College Dublin Ireland
Merrion Research III Limited	Ireland	0.9901%	Third Floor Biotechnology Building Trinity College Dublin Ireland

*Merrion Research II Limited owns 100% of the issued share capital of Merrion Research III Limited carrying voting rights. 0.9901% of the total issued share capital of Merrion Research III Limited (consisting of one non-voting "A" Ordinary Share of €0.01) is owned by Ramalex Limited, a fellow subsidiary undertaking of the group.

The following directors, together with the company secretary, hold the following shares in Ramalex Limited in the following proportions:

- John Lynch – 1 ordinary share of €0.01 and 1 "B" ordinary share of €0.03; and
- Jonathan O'Connell – 1 ordinary share of €0.01 and 1 "A" ordinary share of €0.02.

Merrion Pharmaceuticals plc

Notes *(continued)*

24. Post balance sheet events

On 12 February 2009, Mr. Patrick O'Sullivan assumed the role of Chairman of the Merrion board of directors. Dr. Michael J. McKenna, Chairman since February 2008, remains as a non-executive director of the group.

In January 2009, the group completed a second development and license agreement for oral GLP-1 receptor agonists with Novo Nordisk. In addition, Novo Nordisk invested €900,000 for a 1.8% shareholding in Merrion Pharmaceuticals plc.

25. Approval of financial statements

The board of directors approved these financial statements on 27 March 2009.



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