



Probi is here!

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This is Probi

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

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

Probi has enjoyed a consistent income stream from commercialised products since the mid-1990s. The target customer group comprises leading international companies in the fields of functional food, dietary supplements and clinical nutrition. Probi currently has four licensees for its probiotics, namely Danone, Skane Dairy, Institut Rosell and Health World.

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

Probi is based in Lund and has 19 employees. The Probi share has been quoted on the O-list of the Stockholm Stock Exchange since December 2004.

The year in brief

- Continued collaboration with Danone in the run up to the launch of new products containing Probi's bacteria.
- Launch of dietary supplements containing Probi's bacteria in the USA, France and the UK.
- Patent application for findings showing that Probi's bacteria can affect different parts of the immune system that are important to protection against both infection and the development of diseases, such as type I diabetes.
- A clinical study demonstrated that Probi's bacteria improve the body's ability to absorb iron.
- Probi was awarded a prize by Frost & Sullivan for the successful commercialisation of its bacteria.



What are probiotics?

Did you know that:

Probiotics are live microorganisms (bacteria) which, when ingested in sufficient quantities, have positive health effects? Probiotics work in the gastrointestinal tract in several ways, such as countering harmful bacteria, boosting immunological defences and strengthening the barrier function of the intestinal mucosa. Research data shows that different bacteria have different effects.

Probiotics are live microorganisms that provide positive health effects. Many probiotic organisms are members of the lactobacillus family (lactic acid bacteria) that are normally present in the human gastrointestinal system from birth. Historically, however, the quantity of probiotics that people ingest has declined as a result of changes in dietary habits and lifestyles. Over the last 50 years, we have changed our dietary habits and as a result we ingest far fewer lactobacilli. In the long term, this can be unhealthy, in that it contributes to a chain of negative reactions in the body because the lower levels of probiotics lead to an imbalance in the gastrointestinal tract's bacterial flora. This leads to a risk of a deterioration in the body's immunological defences, among other things. Allergies and a heightened inflammatory status may result, entailing an increased risk of cardiovascular diseases, cancer, type II diabetes and Alzheimer's disease. Research into probiotics has not yet come far enough to fully clarify all of the causal links, but research in this area has increased dramatically in recent years and is gradually providing increased support for the scenario described above.

This research has demonstrated that probiotics have positive effects on gastrointestinal health, e.g. in people suffering from Irritable Bowel Syndrome (IBS). In Japan, the realisation of the importance of probiotics in human health has led to the Japanese equivalent of the Swedish

National Food Administration recommending regular consumption of probiotics.

Food fermented in lactic acid – which mankind has eaten throughout its history – contains useful bacteria. Sauerkraut, pickled gherkins, marinated green olives, yoghurt, soured milk, cheese and salami are all examples of traditional food products fermented in lactic acid that contain large quantities of live bacteria in the form of lactobacilli.

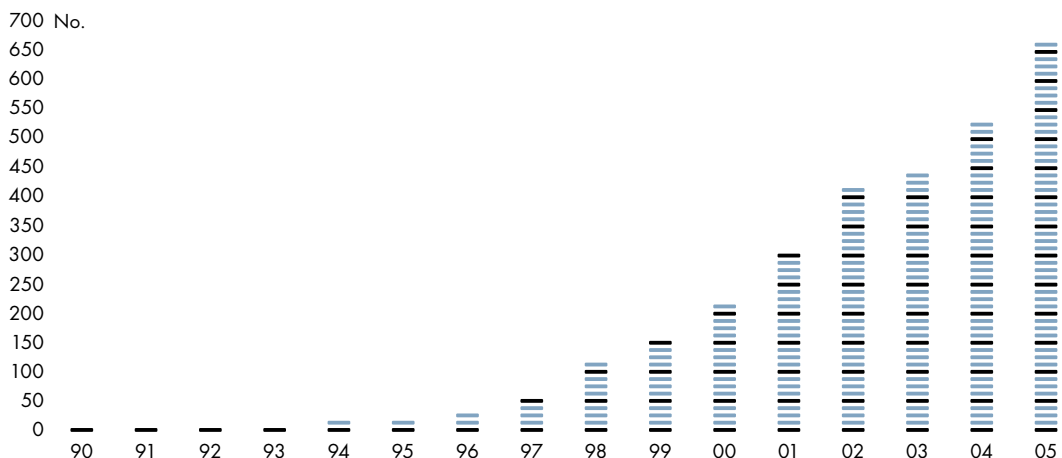
Poor intestinal flora commonplace

Studies have shown that the average Swede has too many bacteria with aggressive qualities in his or her gastrointestinal tract, and too few lactobacilli that have a positive effect on health. This is hard on the system and can cause the body's immune defences to overreact. It is perhaps not so strange that all the food we ingest has an effect on our well-being, given that this food has been exposed to an area the size of a tennis court (approximately 250 m²) by the time it has passed through the entire digestive tract.

Probiotics – a means of control

Probiotics offer the potential for ensuring that the gastrointestinal flora functions correctly, which has led to hopes that it may be possible to influence major public health concerns such as cancer, type II diabetes, and cardiovascular disease. This hope has made probiotics an inter-

Number of scientific articles on probiotics, 1990–2005.



esting field for research, which has led to a dramatic increase in efforts made in these areas. The results of probiotic research are now being published in leading medical journals. If more positive effects can be demonstrated in clinical trials, probiotics may become even more interesting from a commercial viewpoint. Probi is a leading company at the interface between research into probiotics and their commercialisation.

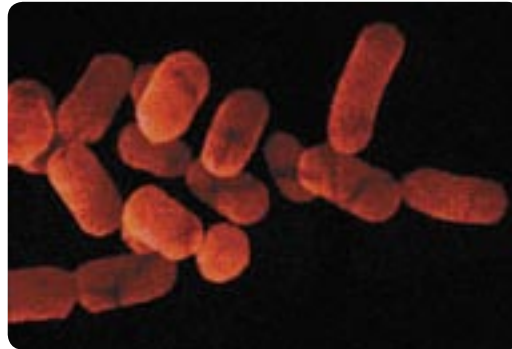
DRIVING FORCES

In the research field

→ New insights into the benefits offered by probiotics.

Among consumers

→ Greater awareness and increased interest in health.



Did you know that:

You should consume several billion beneficial bacteria a day to keep your gastrointestinal tract flora healthy. One drinking glass full of ProViva corresponds to 10 billion beneficial bacteria and boosts the growth of other health-bringing bacteria.

Industry

→ Efforts to achieve higher margins and growth via innovative products.

Authorities

→ Efforts to improve public health and thereby cut health care costs.

PROBI ACTS AS A BAND-AID IN YOUR STOMACH

A diagram of the human digestive system, including the stomach and intestines. A circular inset provides a magnified view of the intestinal wall, showing yellow rod-shaped bacteria adhering to the mucosal surface. The bacteria are positioned between the lumen and the wall, illustrating their protective role.

Probi's bacteria have the ability to adhere to the gastrointestinal wall and protect it from attacks by harmful bacteria (pathogens). This adhesive property enables Probi's bacteria to stimulate the natural growth of the tract's mucosa. The bacteria therefore act as a band-aid that helps the gastrointestinal tract to heal, e.g. when it has been injured or infected.

Probi's business concept and objectives

BUSINESS CONCEPT AND MOTIVATION

Mission statement

Probi shall be a leading research and development company that supplies industrial players in the functional food, dietary supplements and clinical nutrition market areas with commercially interesting product concepts based on bacterial cultures with a probiotic effect.

Vision

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

Fundamental values

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

BUSINESS CONCEPT

The business model in brief

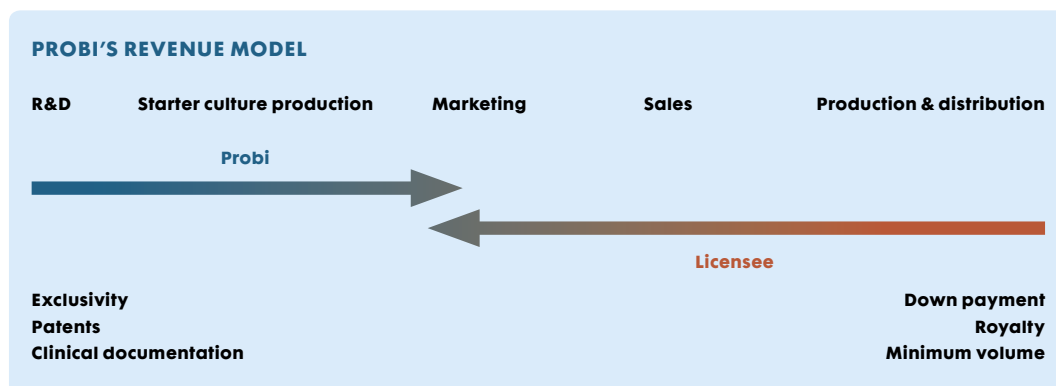
- Probi shall conduct research with a view to identifying, evaluating and clinically documenting interesting bacteria and probiotic concepts.
- Probi shall patent the results of its research to protect the use of its bacteria in a variety of therapeutic fields.
- Probi shall commercialise bacteria in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

Operational goals

- Probi shall, within the next year, develop and commercialise additional product concepts for the food and nutrition market.
- Probi shall retain its position as a successful supplier of clinically documented probiotics.
- Probi shall, through high-quality documentation and extensive patent protection, receive higher royalty revenues for its probiotics than the industry as a whole.

Financial goals set in conjunction with the listing on the stock market in December 2004

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



STRATEGIES

Research

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

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

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

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

Patenting and documentation

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

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

Commercialisation

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

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

Quality

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

The credibility of probiotics

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

Did you know that:

The differences in the genetic make-up of two bacteria can be greater than that between a carrot and a rabbit?

PROBI'S BUSINESS MODEL AND STRATEGY



Research



Patents



Commercialisation

The CEO's statement



Our operations in 2005 were increasingly influenced by international events. The launches of Probi's dietary supplements in Europe and North America began during the year, meeting with particular success in France, where the products are distributed by the pharmaceutical company, Merck KGaA.

The first steps in the international expansion in Dietary Supplements collectively resulted in an increase of 55 per cent in the business area's turnover. We now intend to add more distributors through the network of our partner, Institut Rosell.

The strong launch by Merck KGaA in France shows the importance of being selective in our choice of distributors. Probi's dietary supplements command a higher price, and the distributor must therefore be able to provide high-quality sales support. Entering into partnerships with top-level distributors takes longer, but the results show that this is the right path to take if the product offering is sufficiently strong. We are working continuously to sign more agreements, and I expect to see additional dietary supplement distributors on board in 2006, thereby ensuring a continuation of the healthy growth in this business area.

Danone and other food companies

Probi has chosen to cooperate with the French food giant, Danone, in order to bring about a global product launch for Lp 299v, the bacteria present in ProViva. The project has, however, taken longer than Probi initially anticipated. The delay is primarily due to the fact that Danone is currently working on launching a product under one of its well-established brand names. Customer surveys have thus been performed in greater numbers and greater depth than was previously planned.

Working with a partner of Danone's calibre naturally entails both risks and opportunities, and the project has, to some extent, changed course since its conception. The new focus has led to high levels of activity in the development of a product alternative that contains Probi's bacteria.

Danone's probiotic products, Activia and Actimel, have reported pleasing sales trends for a number of years now. Danone does, nonetheless, need to complement its portfolio with new products and concepts if it is to continue to grow. Probi has a technology that will permit the expansion of Danone's existing product portfolio.

Probi is also engaged in discussions with other food companies, including some companies that are interested in working with Probi to investigate a variety of possibilities in the field of probiotic functional food. Probiotic food products in the functional food area must possess other important qualities over and above the presence of health-bringing bacteria. Taste, shelf-life and consistency are important attributes in making a product attractive to the consumer.

The main income stream for Probi still comes from Skane Dairy's ProViva, and it is pleasing to note that revenues from ProViva performed well in 2005, increasing by 10 per cent. The general trend in the juice market was negative and volumes fell, so ProViva is showing impressive stability. We expect future income from ProViva to continue to develop in a stable manner in the Swedish market.

The dairy industry is changing, and 2005 saw our partner, Skane Dairy, return the UK licensing rights for the ProViva bacteria, Lp 299v. In the short term, this will mean a reduction in Probi's income from the British market. Skane Dairy has announced that it is discussing increased cooperation in alliance with other dairies in the Nordic region, and this may generate new potential for ProViva.

Future potential

Top-quality research and development are vital to Probi, yielding a number of interesting results in 2005. Studies were presented showing that probiotics help increase iron absorption by the body, while other studies showed that the immune system can be controlled using a number of different bacteria. It may prove possible to stimulate a variety of immune system mechanisms with a view to enhancing protection against infections or suppressing overreactions, such as allergies.

A major study of patients in intensive care began in the Netherlands in 2005. The study, which is expected to include 500 patients over a period of three years, aims to reduce the use of antibiotics without simultaneously substantially increasing the risk of infections. In many countries, up to 80 per cent of all intensive care unit (ICU) patients are routinely treated preventively with powerful antibiotics. This usage is not only expensive, it also causes serious problems with antibiotic-resistant bacteria. The general view is that a larger number of more wide-ranging studies are required before probiotics are widely used in the health care system, and the Netherlands-based study involving Probi's probiotics will therefore play an important part in any effective commercialisation of the Clinical Nutrition field.

We have also noted the potential for the use of probiotics in several areas other than intensive care. We are accordingly launching the development of a broader usage concept, primarily in a range of different outpatient care specialisations, for patients who need inflammation relief. There are several areas in which probiotics could potentially be used, including on cancer patients undergoing chemotherapy or radiotherapy, for example. Other possibilities include patients with irritable bowel syndrome and certain conditions that may disrupt the intestinal flora in a wide variety of different ways.

Driving forces

Competition levels have generally increased in the probiotics field. Probi got off to an early start, but we are no longer alone. A number of companies offering a range of probiotics have advanced their positions and this competition has both positive and negative effects. If probiotics are to achieve a large-scale breakthrough, we need more players than just Probi. What we need, in fact, is a multiplicity of players actively marketing probiotics. This trend will in time help to disseminate understanding of the health-bringing properties of probiotics, and this can only be a positive thing.

We saw an increase in levels of interest in probiotics in 2005. One of the world's foremost scientific publications, "Science", published in-depth articles

in March last year on the "inner tube of life" theme, discussing gastrointestinal bacteria and their importance. This is a new trend towards in-depth discussion, in influential contexts, of the importance of gastrointestinal bacteria to our health. Although our knowledge is far from complete, research findings suggest that the presence of probiotic bacteria in our gastrointestinal tracts influences several functions of importance to health.

New applications

Bearing this in mind, I believe that probiotic bacteria will definitely achieve a far broader future usage than is currently the case. Probi's research is on the cutting edge – a fact that was, perhaps, made clearest when Probi was awarded the Technology Leadership Award by the international consultancy company, Frost & Sullivan, for our launch strategy and leading position in the field of probiotic research and development. We are also the first company outside Japan to have succeeded in getting a health claim approved for a probiotic bacterium.

The strength of our research has led us to set ambitious goals for our international expansion. The quality of our research means that Probi encounters considerable interest, but we have also realised that contracts and launches take longer than expected. At the same time, we are focusing on mutually beneficial high-yield partnerships with players who see the commercial value of our products, which are based on strong scientific work. This strategy was praised in the citation for the prize awarded to Probi by Frost & Sullivan, for Probi's work on Dietary Supplements.

To summarise, we can look back on 2005 as an eventful year in which we have successfully advanced our positions in several areas. In spite of disappointing delays, we are working hard and resolutely to find solutions in areas where we have not yet achieved a breakthrough. The work is laborious and demanding, and is being carried out by every single one of our employees and partners, and I would like to end by expressing my warmest thanks to all those who have contributed to our efforts over the past year.

Lund, March 2006



Per Bengtsson

Operations

Probi's market offering is divided into three business areas, namely Functional Food, Dietary Supplements and Clinical Nutrition. Functional Food offers food producers thoroughly documented probiotic bacteria, while Dietary Supplements offers manufacturers and distributors of dietary supplements well-documented, high-quality probiotics. Probi's Clinical Nutrition business area offers probiotic concepts for use in nutritional solutions in the health care sector.

Probi's primary research fields are gastrointestinal disorders, immunological defence, cardiovascular disease risk factors, and stress and performance recovery. Probi chose these fields because they are among those that have the greatest impact on people in terms of health and well-being and because they are areas in which probiotics can have a positive effect.



RESEARCH AND DEVELOPMENT

Probi's research and development forms the basis for the commercialisation of product concepts. The research focuses on live microorganisms with scientifically demonstrated health-bringing effects.

A great deal of research and development work is currently being conducted worldwide in the probiotics field. Biotechnology companies and researchers are looking for probiotics that can influence specific health disorders, increase well-being and target specific types of users. A partnership project is currently under way within the EU, for example, with the aim of finding new probiotics that can improve or maintain the gastrointestinal health of older people.

The obstacles that probiotics must overcome include industrialisation, transportation, and storage in shops, since the bacteria are live organisms. The bacteria must also be able to survive the passage through the acidic environment of the stomach and resist the digestive processes in order to establish themselves in the small intestine. In the large intestine, the probiotics must then compete with the large number of bacteria already found there. Given the above, there is considerable interest in finding probiotics with high survival rates in the intestine, and this is just one of the important areas in which Probi has made substantial progress.

High-performance bacteria

Probi's researchers have discovered the important role of *Lactobacillus plantarum* as a health-bringing bacterium. The plantarum bacterial strain generally performs at higher levels than other bacteria. *Lactobacillus plantarum* has shown itself to be a potent strain: the bacteria have large amounts of genetic material and can perform several different functions, including stimulating the immune system, suppressing inflammation and helping to enhance the barrier function of the intestine by increasing mucosa formation. Bacteria are found in different locations throughout the intestine and perform different functions. Probi is interested in charting the ways in which the different bacteria affect our health. The robust nature of *Lactobacillus plantarum* also makes it an ideal bacterium for industrialisation purposes.

Research activities in 2005

A study was presented in 2005 demonstrating that adding Probi's probiotics to a person's diet improves the body's ability to absorb iron. Iron deficiency and poor iron reserves in the body are a common medical problem in both the western world and developing countries. Younger women are particularly prone to iron deficiency. The problem cannot simply be solved by eating an iron-rich diet, because the body finds it hard to absorb iron, which is why the diet must also contain something that enhances the efficiency of iron absorption.

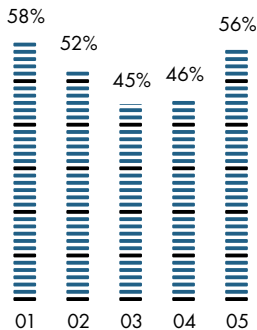
Another study has shown that Probi's bacteria help to increase the number of white blood cells that take part in immunological defence. The results also suggest that Probi's bacteria may have the ability to reduce overreactions on the part of the immune system. It is possible that the development of allergies and autoimmune diseases such as type I diabetes could be prevented. It has not previously been possible to demonstrate clearly that probiotics can have a selective effect on different functions within the immune system, and patent applications have been filed for these findings.

2005 saw Probi launch a partnership with a group of researchers in Maastricht in the Netherlands to investigate the treatment of patients in intensive care units (ICU). The background to the investigation is findings indicating that a number of ICU patients have died as a result of leaks in the intestine rather than because of the original reason for which they were admitted. A leaking intestine can lead to aggressive bacteria leaking out into the body and causing dangerous infections and inflammations. Previous studies have shown that one of Probi's bacteria reduces the frequency of infections in intensive care from 40 per cent to 10 per cent, and that they can help cut stays in intensive care by up to two days. The goal of the new research programme in Maastricht is to treat 500 people over a period of three years in what will be a considerably more comprehensive study than any earlier ones. If the programme confirms the findings of previous studies, it will open the door to significant commercial potential in the field of intensive care treatment.

Did you know that:

Mankind has used lactic acid bacteria for tens of thousands of years, without knowing why bacteria in our diet are good for us? It was only recently that the scientific mapping of the importance of probiotic bacteria in the diet began and that research was launched into the underlying mechanisms that enable a range of different health claims.

Research costs as a percentage of Probi's operating income:



Did you know that:

There are more than 100 strains of the *Lactobacillus* species, but only a few are suitable for industrial use, e.g. in food products? And there are even fewer probiotic lactobacilli. A species is a broad collective term that can be divided into strains. The genetic variation between different strains is incredibly large, and all of the strains have different properties. Only an extremely limited number of all these strains have demonstrated health-bringing properties and can therefore be called probiotic.

As in previous years, Probi's research work has also focused on product development in cooperation with its licensees, Danone and Institut Rosell.

THE RESEARCH PROCESS

Commercialisation of product concepts is founded on Probi's structured research and development process, from initial research to launch. The bacteria are tested on a laboratory scale and suitable bacteria are selected. The bacteria's properties are then characterised with the aid of a variety of test methods. Selected bacteria then undergo additional investigation and testing.

Phase one of the clinical trials entails identifying and characterising interesting bacteria that meet important requirements, such as survival in the gastrointestinal tract and the absence of side-effects. In this context, Probi applies models similar to those used in the pharmaceutical industry in order to identify and evaluate the probiotic effects of bacteria.

Probi's clinical trials then enter phase two, where tests are conducted on a small group of patients with the help of the company's partnerships with various academic research groups. This enables the effects of Probi's probiotics to be further documented. The goal of the clinical studies is approval for a product-specific health claim. In the final stages of the process, Probi's customers develop the consumer product, normally with the assistance of Probi in the form of documentation and experience.

Network of researchers

Probi cooperates with a network of researchers at universities and institutions in Sweden and abroad in order to optimise the costs and direction of the research and development work. Probi utilises research capacity on a project basis and also applies for grants for its research, e.g. from the EU.

The multiplicity of interesting research areas and the fact that Probi has been able to offer bacteria that no one else could offer have been critical to the successes of this network. The encouraging research findings have also acted as a driving force for the international network. Working with Probi has led to research credits and the partnership with Cornell University out-

side New York is just one example of a successful exchange within the network.

There is a trend towards increasingly focused research, because performing research on several fronts is resource intensive. Probi will primarily maintain its focus on the *Lactobacillus plantarum* strain – an area in which the company is breaking new ground. The strain has a larger body of genetic material than most lactobacilli and has a number of interesting properties that make it highly viable in probiotic products. Probi is also complementing these efforts with research into other interesting bacteria with a view to meeting other health requirements and maintaining a broad product offering. The financial goals that relate to Probi's operating margin include a requirement that R&D costs after a five-year period (as of 2009) shall not exceed 30 per cent of income.

PATENTS

Patents provide value and protection for both Probi and the company's customers, and Probi accordingly allocates substantial resources to effective patent protection for its research. Probi now holds patents for numerous probiotic strains and also holds complementary patents with regard to the probiotics' effects. The company has a total of 113 patents, taking into account all its geographic markets. From a pharmaceutical perspective, probiotics have long patent protection durations because the development time for probiotic preparations is normally only half that for pharmaceuticals. The patent portfolio is analysed regularly from a strategic viewpoint with a view to optimising the existing protection, e.g. via documentation and studies.

As a general rule, licensing revenues are determined by the effective patent duration, i.e. the patent duration remaining when the product is launched. Broad commercial agreements often include numerous patents, however, and when this is the case, Probi has sought solutions whereby royalties are paid with no reduction for as long as there is a patent in force. The strain patent for Lp299v is the most important patent in terms of Probi's existing commercial agreements. Probi has applied for patents in the areas of immunology and nutrition in 2005.

Organisation and employees

Today's Probi is an efficient organisation with 19 employees. Probi focuses on working in partnership with a limited number of large international partners who can cover the various geographic markets.

The partner companies handle marketing to the consumer, and a small marketing department is thus sufficient to meet Probi's requirements in this respect. The fact that much of the research is conducted via a network that includes Swedish and international universities also helps to keep the organisation small and cost-effective. Some of the research is also partially financed by scholarships and other research grants. When extra capacity is required, the services are bought in temporarily on a consultancy basis.

Experienced research personnel

Probi's operations focus on probiotic research, and Probi has therefore, among other things, invested heavily in attracting staff with in-depth research experience. The company employs research personnel with experience in the fields of medicine, microbiology and food chemistry. Eight of the company's 19 employees have doctorates. Probi's headquarters are located in the Ideon Research Park in Lund – a location that enables research and information exchanges, as well as contacts between universities and companies in a stimulating environment.

Over and above its research and marketing organisations, Probi also has finance, administration, production, product development, and business development functions. In terms of gender breakdown, the company's employees included ten women and nine men at the end of 2005. Two people left the company in 2005, but two more people were employed. The age distribution is shown in the table alongside. Probi strives to be a workplace that is attractive to both existing and potential employees.

Total sickness absence in relation to total number of hours worked in 2005 was 0.9 per cent.

FLEXIBILITY

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

VALUES

Probi shall be characterised by:

→ Know-how and expertise

Probi shall be characterised by know-how and expertise in all areas. This is what Probi's partners demand and what attracts personnel and other partners, making them keen to work with Probi.

→ Dedication

Dedication to working with Probi's products means a level of commitment over and above the norm. It involves dedication to research and to the development and marketing of products that improve people's health.

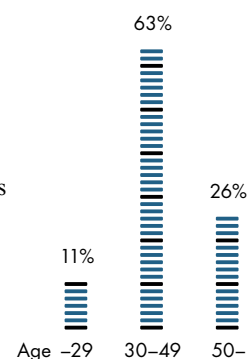
→ Credibility

Credibility is the key if partners are to choose Probi and end-consumers are to be keen to buy the products.

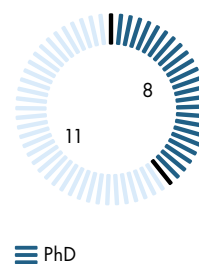
→ Curiosity

Probi started as a research company that was born from a discovery. Curiosity is a strong driving force and Probi's work entails exploring new paths.

Age distribution



Educational level, number



Functional Food

- Interest in health continues to work in Probi's favour
- Probi can help boost licensees' margins
- Studies show that Probi's bacteria have significant commercial potential



Did you know that:

The term "functional food" refers to food products that have been enriched with ingredients that have positive effects on health over and above the normal nutritional value of the food?

The primary function of probiotic functional foods is to help improve gastrointestinal health and boost immunological defence. These areas have accounted for the majority of sales in recent years and are expected to develop still further in the years to come. Consumers are also interested in products that offer health improvements in other areas – areas in which probiotics, with their extensive health-bringing effects, may become an important factor.

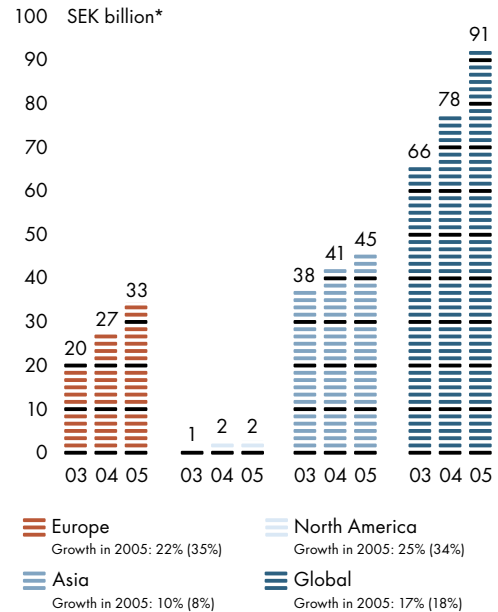
PROBI'S OFFERING

Probi offers food producers thoroughly documented probiotic bacterial additives. Probi has conducted a number of clinical trials of various probiotic bacteria and has successfully demonstrated positive health-bringing effects on gastrointestinal disorders, stress and performance recovery. Studies carried out in 2005 showed that Probi's bacteria can boost the immune system, while other findings suggested that they may provide added protection against autoimmune diseases, such as type I diabetes. Further studies have also shown that Probi's probiotics can reduce iron deficiency and increase absorption of other minerals. Iron deficiency is a widespread problem in women. Together with the studies reported in 2005, this offers interesting commercial potential.

Probi's existing customers are food companies that distribute chilled products. As the probiotic bacterial strains and product solutions become more stable, it may also become feasible to use them as additives in room-temperature foods, such as energy bars, biscuits or breakfast cereals. Probi's best documented bacteria, Lp299v, have demonstrated excellent survival rates in acidic environments, such as juice, offering substantial potential alongside the more common milk-based products.

Adding Probi's probiotics increases the value added of the licensees' products, enabling them to charge higher prices and increase profitability.

Sales of probiotic foodstuffs



Euromonitor, IMIS 2006.

*All estimates of market sizes are shown in SEK, converted at exchange rates of USD 7.50 and EUR 9.15.

THE MARKET

The global market for probiotic products is showing healthy underlying growth. New insights into the benefits of probiotics, an increasing level of public interest in health, and the authorities' increasing demands for documentation and regulation are the primary driving forces from which Probi is benefiting.

On an international basis, the highest per capita consumption of probiotic foods is found in Japan. One reason for this is that probiotic drinks have been available in the Japanese market for several years now, and many Japanese have a positive attitude to the effects of probiotics. Japan also has a highly developed regulatory system that permits the communication of health benefits, making it easier for the consumer to choose between different probiotics.

In recent years, the use of probiotic foodstuffs has grown faster in Europe than in the rest of the world. This trend is being promoted by extensive marketing on the part of major producers of probiotic foods, including Danone, with their Actimel and Activia/Bio products.

The market for probiotic functional food is valued at around SEK 90 billion. Probiotic foods comprise approximately 15 per cent of the functional food market. The annual growth rate in recent years is around 15 per cent compared with a rate of 4 per cent for the food market as a whole. Probi believes that the growth rate for probiotic foods will remain on a par with that seen in recent years.

Probiotic foods are currently dominated by dairy products, such as fermented milk drinks, probiotic yoghurts and probiotic yoghurt drinks. The market's biggest players include the Japanese firm, Yakult, and the French firm, Danone, followed by the Japanese firm, Morinaga, and the Swiss firm, Nestlé. The bigger players have further consolidated their positions in recent years, and Yakult and Danone now have a collective market share in excess of 50 per cent.

In the longer term, probiotics are expected to be used in a wider range of products, such as a variety of fruit drinks. To date, however, only a few of the world's producers of probiotic bacteria, including Probi, have successfully developed thoroughly documented probiotic concepts for fruit drinks. This is because fruit drinks often constitute demanding environments in which it is difficult for bacteria to survive for a sufficient length of time.

Challenges and opportunities

A number of surveys* in 2005 showed that the main reason why consumers are hesitant about functional food is that they did not believe the claims of health-giving effects and/or did not believe the producers.

The market offers substantial opportunities, but it also presents major challenges. The main challenge faced by the producers lies in convincing consumers of the credibility of the food products' health-related value added properties.

*AC Nielsen, Datamonitor

CONSUMER GUIDANCE

A number of countries have chosen to regulate the ways in which functional food may be marketed, the aim being to protect and guide consumers. The evaluation of the scientific documentation that underpins a health claim is an important goal in this context. Japan and Sweden are pioneering countries in the functional food sector and are among the countries to have progressed the most in regulating health claims. Only a few countries within the EU have so far formulated regulations governing health claims, however, and these regulations vary from one country to another. In Sweden, product-specific claims in the functional food sector are approved by the Swedish Nutrition Foundation.

From a marketing perspective, probiotics can be divided into three tiers:

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

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

A new set of regulations that will apply throughout the EU is being drafted and is expected to resemble the Swedish system. This system is not however expected to have any concrete impact in terms of marketing for some years to come.

CUSTOMERS

Danone

In 2003, Probi signed a licensing agreement with the French firm, Danone, which has established a strong position in the market for probiotic functional foods. Danone now has two strong probiotic foodstuffs, namely Actimel and Activia/Bio. Danone has also invested heavily in other probiotic food companies, such as the Japanese firm, Yakult, and the American firm, Stonyfield Farms.

The licensing agreement gives Danone exclusive rights to sell certain types of food products that contain Probi's Lp299v bacteria. The exclusivity is global, with the exception of the Nordic region and the UK.

Did you know that:

Annual consumption of probiotic foods totals SEK 252 per capita in Japan, while in Europe, it is only SEK 70 and in North America, it is as low as SEK 8.

Under the Activia brand name, Danone has worked methodically to identify product profiles that are attractive to consumers and thus offer commercial potential.

Activia focuses on gastrointestinal health and sales have performed very well. Danone requires new products in the gastrointestinal health field to make a positive contribution to Danone's sales without disrupting Activia's position, and more extensive market studies are therefore required for Probi's bacteria than were originally planned. The project's original timetable has consequently been put back.

Probi's technology is strong and Danone is continuing to invest substantial resources in Probi's bacteria with the aim of developing product concepts that offer the kind of growth potential not possible with the existing product range.

Skane Dairy

Royalty revenues from the sale of the ProViva fruit drinks increased by 10 per cent in 2005 in comparison with the total market for juices, which fell by a couple of per cent during the year. The market performance was negatively affected by the debate about sugar in foodstuffs that continued throughout the year. The limited effect on sales of ProViva was largely due to the introduction by Skane Dairy of a number of low-sugar products.

Skane Dairy started manufacturing and distributing the ProViva health drink in 1994. It has been a sales success in Sweden ever since, with revenues from ProViva growing by over 10 per cent each year. Retail sales of ProViva totalled approximately SEK 300 million in 2005. ProViva contains Probi's Lp299v bacterium and is currently available in the form of fruit drinks, fruit shots and yoghurt. Its success is due to its unique properties in the segment. Under the current agreements, Skane Dairy is allowed to manufacture various types of food product containing Lp299v for sale in the Nordic region. Sales of ProViva have not performed as planned in the UK, and in September 2005, Probi revoked the license for the UK.

The partnership with Skane Dairy has been important to Probi for a number of reasons. Among other things, ProViva's success in Sweden has confirmed Probi's commercial potential internationally. After a review by an interna-

tional committee of experts, ProViva has also been granted approval as the only probiotic product in Sweden that can make a claim regarding the specific health effects of the product.

THE FUTURE

Gastrointestinal troubles are at present the therapeutic area where there is the greatest demand for probiotic food products. In tandem with new research findings, however, the therapeutic areas of use maybe extended to diabetes, cholesterol reduction, infections, influencing the immune system and inflammatory conditions, blood pressure reduction, and other areas involving human metabolism, for example.

Development work on methods of adding bacteria to non-chilled foodstuffs is also of interest for the future.

Looking further ahead, one of the biggest challenges facing us is educating consumers on health and nutritional matters. Players such as Danone, Yakult and, in Sweden, Skane Dairy, have shown that considerable commercial potential exists in the probiotics field, but realising this potential requires the market players to be successful in translating medical findings into effective, communicable and approved health claims or food concepts. People's willingness to pay for their well-being and the desire to feel good and be healthy will be key factors in fuelling future sales.



The addition of Probi's bacteria to yoghurt or juice, for example, can generate health-related value-added benefits. Probi's bacteria add scientifically documented, positive health-bringing effects to the food product. This gives food producers the opportunity to justify a higher price for their products.

Dietary Supplements

- **Dietary supplements containing Probi's bacteria were launched in the UK and France**
- **Institut Rosell expects to sign new distribution agreements in 2006**
- **The partnership with Health World developed well**

PROBI'S OFFERING

Probi offers manufacturers and distributors of dietary supplements well-documented, high quality probiotics. The offering is principally based on concepts that have proven successful in the functional food sector.

MARKET

The global market for dietary supplements, excluding vitamins, totals approximately SEK 150 billion, of which probiotic dietary supplements account for around SEK 6.5 billion. The probiotic dietary supplements sector is however growing faster than the rest of the dietary supplements market, reporting an annual growth rate of 12 per cent. The future growth rate will, in Probi's view, be on a par with that seen in recent years. The market continues to be fragmented, with a small number of players operating in several markets, although there are signs now of some larger players implementing launches in several countries, e.g. Merck's launch of the Bion3 product.

OPERATIONS

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

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

CONSUMER GUIDANCE

The market for probiotic dietary supplements is still characterised by local conditions with regard to legislation and distribution. The lack of any overall international regulatory framework makes it difficult to implement international registrations and launches, and very few products have therefore achieved any sort of widespread dispersal. Within the EU, there are directives governing dietary supplements' contents lists, and these resulted in the Swedish National Food Administration's new regulations, which came into force in Sweden in 2005. So far, however, the Swedish regulations do not contain any rules governing health claims.

CUSTOMERS

Institut Rosell

Probi's French-Canadian partner, Institut Rosell, is one of the leading suppliers of probiotic dietary supplements in the USA and Europe. Institut Rosell launched the first product to contain Probi's probiotic bacteria in Europe in the summer of 2005, and the autumn saw the launch of sales in France, increasing royalty incomes within the business area.

The partnership, which was initiated in 2003, gives Institut Rosell the right to market and sell dietary supplements in the form of capsules, tablets and sachets containing Probi's Lp299v bacterium. The agreement gives Institut Rosell the exclusive right to market dietary supplements in the therapeutic area of IBS (Irritable Bowel Syndrome). Distribution in the UK and France is handled by Quest Vitamins and Merck KGaA respectively. Distribution in the USA has been handled by Healthy Directions, formerly known as Phillips Health, since early 2005. Institut Rosell is endeavouring to carry out additional launches via other sales channels and markets.



Facts

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



Health World

Probi's partnership with Health World, Australia's biggest supplier of probiotic dietary supplements, performed positively in 2005. Health World has started selling dietary supplements containing Lp299v via new market channels. It has also added new products to its range, and its augmented marketing via TV, etc. has had a positive impact on volumes.

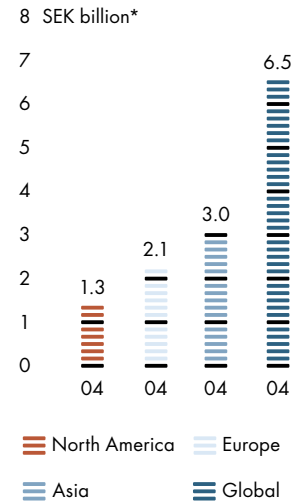
The partnership agreement gives Health World the right to sell dietary supplements containing Lp299v in Australia and New Zealand. The products include powders and capsules that can be marketed exclusively in the therapeutic area of IBS.

THE FUTURE

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

Probi is also engaged in discussions with potential distributors outside Institut Rosell's territory. Probi expects to sign additional agreements, with new distributors and for new geographical markets, although full volume development is not expected in 2006. Overall, Probi views the future potential of the dietary supplements market in a positive light.

Sales of probiotic dietary supplements



Euromonitor, IMIS 2006.

*All estimates of market sizes are shown in SEK, converted at exchange rates of USD 7.50 and EUR 9.15.

Clinical Nutrition

- Promising potential uses for probiotic concepts in intensive care
- Development of probiotic concepts for various patient groups in outpatient care
- Business development aimed at concluding the first licensing agreement continues

PROBI'S OFFERING

Probi offers probiotic concepts for use in nutrient solutions used in the medical sector. Probi has developed an initial product concept that targets specialised intensive care, and it has undergone clinical trials in well-defined patient groups, e.g. patients with acute pancreatitis. The concept's area of use is being expanded through the large-scale research programme launched in the Netherlands in 2005 and a new offering is now planned, including new studies of probiotic usage, e.g. in cancer treatment and care.

THE MARKET

Clinical tests of probiotics used in clinical nutrition have shown excellent potential for both improving health and saving money in the medical sector. The bacterial flora of patients in intensive care units at hospitals is often substantially reduced as a result of intense courses of antibiotics treatment, etc. This allows pathogenic bacteria to emerge and cause complications, such as diarrhoea, inflammations or serious infections, including blood poisoning. Nutrient solutions that contain probiotics can help to restore the bacterial flora in these patients' digestive tracts.

Probi can offer clinical documentation for probiotic use in various types of nutrient solution. Potential customers primarily include nutrition companies and pharmaceutical companies offering nutritional products. Probiotics are not currently used in nutrient solutions, but scientific progress in the field makes it likely that probiotic products will be introduced in the area of clinical nutrition.

The products are generally prescribed by physicians for a specific health-related reason. The factors providing the driving forces behind clinical nutrition products containing probiotics are primarily expected to be:

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

Sales statistics for probiotic clinical nutrition are unavailable because no significant product has yet been launched.

CONSUMER GUIDANCE

The regulations and documentation requirements governing clinical nutrition products are considerably less extensive than those applying to pharmaceutical products. The former are classified as "foodstuffs for special medical purposes", reflecting the fact that food is perceived as being generic, and more extensive review is therefore not required. Extensive clinical trials are required for more advanced clinical nutrition, e.g. products containing probiotics, if these products are to be used more widely. The medical and health-economic advantages of clinical nutrition containing probiotics are documented as part of these clinical trials.



Did you know that:

The term "clinical nutrition" refers to specialised nutritional products intended for use in inpatient and outpatient care?

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

CUSTOMERS

International interest in probiotic therapy has increased, although it has taken longer than expected to sign an initial licensing agreement within the business area, where income is not expected to be generated until one year after an initial agreement is signed. Royalty income from Probi's continued investment in clinical nutrition is thus not expected until the end of 2007 at the earliest.

THE FUTURE

The widespread use of antibiotics in hospitals is contributing to the development of resistant strains of pathogens – bacteria that cause disease. This increases the risk of patients being infected, resulting in grave suffering and, in a worst case scenario, even death. If the use of antibiotics can be reduced by giving probiotics preventively, it is possible that the risk of antibiotic-resistant bacteria developing in hospitals can also be reduced. Antibiotics could then be used when they are genuinely needed. Antibiotic use in hospitals forms the background to an ICU-based study involving Probi's probiotic concept and currently being conducted at the University Hospital in Maastricht. The study, which will last three years, will seek to determine, among other

things, whether patients who receive a probiotic product require routine treatment with powerful antibiotics.

The ongoing strategy in Clinical Nutrition entails an expansion of the product concept into therapeutic areas other than intensive care, such as inflammatory bowel disease, disruptions of intestinal motility, bacterial overgrowth in the intestine and cancer.

There are numerous illnesses where established therapeutic methods can wipe out large parts of the gastrointestinal microflora. This is true, for example, of cytostatic treatment (chemotherapy) and radiation, where probiotics can reduce both the problems and side-effects of the treatment. Probi will be launching a study in this field in 2006.

Ethics and quality

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

CERTIFICATION

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

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

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

PRODUCTION QUALITY

In addition to all the standard monitoring functions, Probi also performs extensive analyses of every new batch of bacterial cultures produced. Microbiologists ensure, among other things, that the bacterial content is correct and that hygiene maintains the highest possible standards. Identity analyses are also performed during which fermentation patterns and genetic profiles are checked against the original culture. This process also includes tests of the bacterium's function.

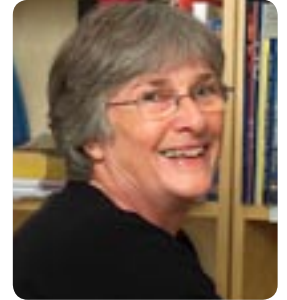
Probi produces its bacteria in its cultivation facility at the Ideon Research Park in Lund. The production of fermented oat substrate takes place in our own factory in Sösdala outside Hässleholm. The production units are capable of handling a substantial increase in volume using existing capacity and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

SECURITY

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

ENVIRONMENT

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



Anne-Marie Lindberg,
Quality Manager

"Our customers are demanding more and more in terms of the quality assurance of our production and accreditation for the analyses we carry out. It's also important to develop this work to ensure we can meet future requirements."

Probi's share

On 30th December 2005, the closing price for the Probi share was SEK 32.00 (SEK 30.00), corresponding to a market value of SEK 300 million (SEK 281 m). The highest price paid during the year was SEK 34.00 (30th December), and the lowest was SEK 22.50 (27th April).

A total of 2,459,769 shares were traded in 2005, corresponding to 26.2 per cent of the total number of outstanding shares. On a yearly basis, this means that 26.3 per cent of the total number of outstanding shares were traded.

Probi's share has been quoted on the O-list of the Stockholm Stock Exchange since December 2004, after having been previously quoted on the NGM Equity list of shares since 1998.

SHARE CAPITAL

Probi's share capital at the end of 2005 totalled SEK 46,826,500 (SEK 46,826,500), spread over 9,365,300 shares with equal voting rights and equal entitlement to a share in the company's profits and assets. The nominal value of the share is SEK 5. Probi's shareholders' equity totals SEK 75.6 million after the net result for the year.

NUMBER OF SHAREHOLDERS AND OWNERSHIP BREAKDOWN

The total number of shareholders registered with VPC (the Swedish CSD) on 31st December 2005 was 4,654 (5,297). At the turn of the year, Probi's ownership broke down as follows: 46.2 per cent private ownership, 10.9 per cent owned by institutions, and 18.6 per cent foreign ownership.

PRINCIPAL OWNERS

Probi's two principal owners, Skane Dairy and H&B Capital, jointly control approximately 25.5 per cent of the votes and capital.

STOCK OPTIONS ISSUED

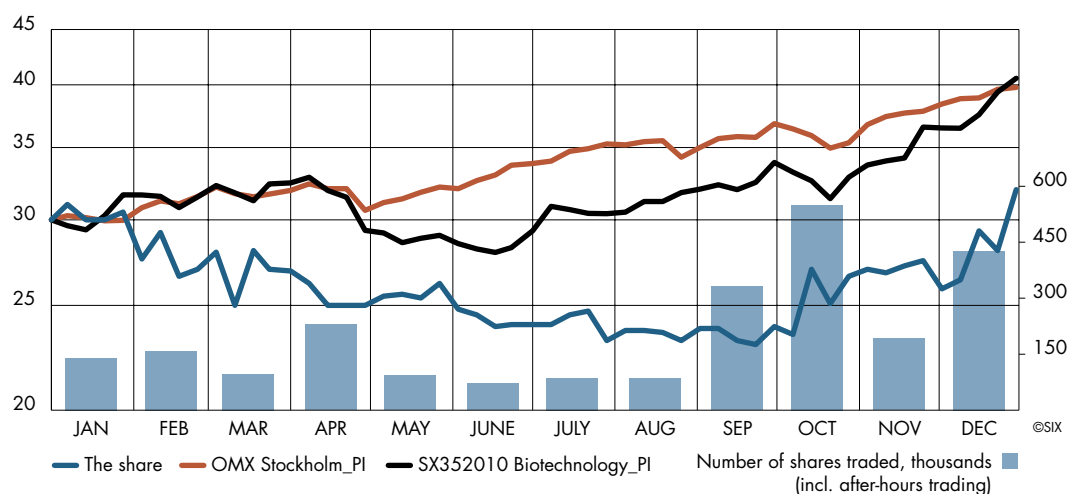
The principal owners issued a stock options programme to the CEO and a member of the management group, corresponding to 40,000 and 20,000 stock options respectively. The options were acquired on market terms and entitle their holders to buy shares at a price of SEK 44 during the period from 1st January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

Probi currently has no other outstanding option or share-related incentive programmes whereby the company has issued or made available warrants, convertible debentures, stock options, synthetic options or similar financial instruments.

DIVIDEND POLICY

The Board of Directors has proposed to the Annual General Meeting that no dividend be paid for the 2005 financial year. Probi's operations over the next two years will require considerable resources and the company therefore believes that no dividend will be paid until after 2007.

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



Share capital development

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

¹ The issue was directed at founders and senior executives.

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

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

Data per share

	2005	2004	2003	2002	2001
Number of shares on 31/12, thousand	9,365	9,365	8,223	8,223	8,223
EPS, SEK	-0.94	-0.71	-0.99	-1.72	-1.45
Shareholders' equity per share, SEK	8.06	9.01	7.10	8.09	9.81
Cash flow per share, SEK	-0.77	2.86	0.10	-3.64	-3.38
Share price on 31/12 (final price paid), SEK	32.00	30.00	40.00	15.00	29.50
Price/Shareholders' equity per share, multiple	3.97	3.33	5.64	1.85	3.01
P/E ratio, multiple	neg	neg	neg	neg	neg
Dividend, SEK	–	–	–	–	–
Market capitalisation on 31/12, SEK k	299,690	280,959	328,900	123,338	242,564

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

Shareholders

	Number of shares	Percentage of share capital and votes, %
H & B Capital Lp	1,212,542	12.95
Skane Dairy Ek för	1,170,903	12.50
The Pecunia fund	740,800	7.91
KI Chem AB	566,333	6.05
Molin, Göran with companies	438,241	4.68
Jeppsson, Bengt	407,517	4.35
Ahrné, Siv	229,573	2.45
Johannesson, Eskil	219,750	2.35
Lönner, Clas	212,568	2.27
Douglas, Gustaf	200,000	2.14
Other (4,644)	3,967,073	42.35
Total	9,365,300	100.00

Shareholding per shareholder

Share distribution	Number of owners	Number of shares	Percentage of shares, %
1–500	3,442	633,474	6.76
501–1,000	621	473,543	5.06
1,001–5,000	478	1,039,097	11.10
5,001–10,000	67	470,468	5.02
10,001–15,000	13	160,102	1.71
15,001–20,000	4	64,640	0.69
20,001–	29	6,523,976	69.66
Total	4,654	9,365,300	100.00

Risk factors

RELIANCE ON A FEW PARTNERS

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

STRATEGIC RESEARCH PARTNERSHIPS

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

KEY INDIVIDUALS AND EMPLOYEES

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

PROBIOTIC REGULATION

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

PROBIOTICS FOR THE MEDICAL SECTOR

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

DOCUMENTATION AND PATENT PROTECTION

Probi's commercial successes are largely dependent on its ability to protect patents and generate new research findings of the highest quality, since a high degree of inventiveness is increasingly required as activity grows within the probiotics sector.

COMPETITION

International competition from probiotics suppliers has increased in all of Probi's business areas. The markets in the probiotic functional food and clinical nutrition sectors verge on oligopolies.

COMPETING RESEARCH INCREASING

Threats to market growth include substitute products, less serious players and a trivialisation of probiotics.

FUTURE CAPITAL REQUIREMENTS

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

FINANCIAL RISKS

Probi's partnerships with international customers entail revenues in several different currencies, and these are affected by exchange rate fluctuations. The primary source of revenue at present is Skane Dairy, and under the terms of the contract, these revenues are always paid in SEK, irrespective of whether they derive from royalties in countries other than Sweden. A small percentage of revenues during 2005 were in EUR, but revenues in foreign currencies will increase as royalty revenues from new agreements grow. Probi has borrowed approximately SEK 4 million on the production facility in Sösdala at a variable interest rate. An increase of 1 percentage point in the interest rate would mean an increase of approximately SEK 40,000 in interest expenses. The company has no interest-bearing operating liabilities.

Annual checks (impairment tests) are carried out to determine whether any write-down requirement exists for patents and licenses. The European rights are amortised linearly from the acquisition year until 2012. Probi monitors product launches by its partners closely, together with development work for impending launches. The assessment of this information forms the basis for decisions as to when the company performs write-down evaluations.

Five-year overview

SEK thousands	2005	2004	2003	2002	2001
Summary of the income statement					
Net turnover	27,236	31,619	27,462	26,063	18,992
Total operating income	27,322	31,915	27,470	27,257	20,697
Total operating expenses	-36,821	-39,003	-35,998	-39,768	-34,654
Operating result	-9,499	-7,088	-8,528	-12,511	-13,957
Result after financial items	-8,833	-6,675	-8,180	-14,128	-11,925
Net result for the year	-8,833	-6,675	-8,180	-14,128	-11,925

Key ratios	Definition					
Equity/assets ratio, %	1	91.1	90.1	80.8	88.3	73.1
Debt/equity ratio, %	2	4.8	4.5	6.7	6.2	5.0
Return on capital employed, %	3	-10.4	-8.6	-12.0	-14.6	-13.3
Return on equity, %	4	-11.0	-9.4	-13.1	-19.2	-13.8
Cash liquidity, %	5	1,161	903	247	487	205
Share in operating income of research costs, %		56	46	50	50	54
Average number of employees		18	17	15	17	16

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

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The Directors' Report

The Board of Directors and the CEO of Probi Aktiebolag (publ), company reg. no. 556417-7540, the registered offices of which are in Lund and the address of which is: Ideon Gamma 1, SE-223 70 Lund, Sweden, hereby present the annual accounts and the consolidated accounts for 2005. The annual accounts will be adopted at the Annual General Meeting held on 9th May 2006 in Lund.

Unless otherwise specifically indicated, all amounts are shown in SEK thousand. Figures in parentheses refer to the previous financial year.

Probi was founded in 1991 and is now a leading player in the field of probiotic research and development. The company's research relates to live microorganisms with scientifically demonstrated health-giving effects. The main fields of research are: Gastrointestinal complaints, Immunology, Risk factors for cardiovascular disease and Stress and performance recovery.

Probi's business concept is based on offering effective and well-documented probiotic product concepts with extensive patent protection, thereby creating the potential for higher royalties than in the industry as a whole.

Probi's share has been quoted on the O-list of the Stockholm Stock Exchange since December 2004.

OPERATIONS IN 2005

Probi has reported positive results for the company's research focusing on public health concerns during the year. Probi has already obtained proof that the Lp299v bacterium relieves gastrointestinal disorders, but the findings of two new studies presented during the year reveal other new areas in which the company's bacteria may have health-giving effects.

The results of the first study performed on healthy test subjects show that Probi's bacteria, used selectively, can affect a variety of functions in the immune system. The study won an award at a scientific congress in Krakow and examined the effect of different bacteria on different types of white blood cells. Not only did the number of cells involved in immunological defence increase, but the results also suggest that Probi's bacteria may have the ability to reduce overreactions by the immune system that lead, for example, to type I diabetes. This type of selective effect on different functions within the human immune system by different types of probiotic bacteria has never previously been demonstrated. Patents have been sought for the findings.

Probi also reported the results of a study of iron absorption in 24 healthy women during 2005. The study's results show a marked increase in the ability to absorb iron, which means that ingesting products containing Probi's probiotics should enable a reduction in iron deficiency, a widespread problem among women. Iron deficiency and low iron reserves in the body are a common medical problem, and one to which younger women are particularly

prone. The problem cannot simply be solved by eating an iron-rich diet, because the body finds it hard to absorb iron.

The most important events during the year also include the testing of Probi's bacteria in a large-scale intensive care study that began during the summer. The study is expected to last three years and to include 500 patients. The study is an academic project for which Probi is supplying the product and which will impose only a minor financial burden on the company.

FUNCTIONAL FOOD

Ever since 2003, Probi has had a licensing agreement with Danone, the world's biggest supplier of chilled dairy products and Europe's dominant supplier of probiotic products. Probi's probiotic bacteria offer Danone growth potential in areas outside of its current product offering.

As noted earlier, Danone's original plans to launch a product containing Probi's Lp299v bacterium have been delayed. The delay is primarily due to the fact that Danone is currently working on the launch of a product under one of its well-established brand names. This has resulted in customer surveys being carried out in greater number and depth than previously planned.

Despite declining juice volumes in Sweden in recent years, income from Skane Dairy's ProViva range has increased. In the UK, however, sales of ProViva did not develop as planned, and in September 2005, Probi revoked the UK license. In the short term, this will mean a reduction in Probi's income in comparison with last year, but revoking the rights from Skane Dairy clears the way for Probi to exploit Lp299v in the UK market.

DIETARY SUPPLEMENTS

Royalty income in the Dietary Supplements business area has increased in comparison with the previous year. Probi's partner, Institut Rosell, one of the leading suppliers of probiotic dietary supplements in the USA and Europe, launched the first product containing Probi's probiotic bacteria in Europe during the summer of 2005 via Quest Vitamins in the UK and via Merck KGaA in France in September.

CLINICAL NUTRITION

Development work is continuing within the Clinical Nutrition business area and new product concepts have been developed with the aim of establishing cooperation with a partner. International interest in probiotic therapy has increased, but concluding a licensing agreement in the business area has taken longer than originally expected.

Clinical tests of probiotics used in clinical nutrition have shown excellent potential for both improving health and saving money in the medical sector. The bacterial microflora of

patients in the intensive care units of hospitals is often substantially reduced as a result of courses of antibiotics, etc. This allows pathogenic bacteria to emerge and cause complications, such as diarrhoea, inflammation or serious infections, including blood poisoning. Nutrient solutions that contain probiotics can help to restore the bacterial flora in the patients' digestive tracts.

Probiotics are not currently used to any great extent in nutrient solutions, but there is every chance that this will change in the future. Probi is a pioneer in this area and can offer clinical documentation for probiotic use in various types of nutrient solution, which may well accelerate any such trend. Potential customers primarily include primary nutrition companies and pharmaceutical companies offering nutritional products.

A study of 500 patients has been launched during the year in order to document the effects of Probi's bacteria. The study will not impose any major burden on Probi's financial results because it is being conducted as part of an academic research programme.

PERSONNEL

Probi had 19 employees at the end of the year, 10 of whom are women and 9 of whom are men. The average number of employees during the year was 18 (17). The company now employs 8 (7) researchers who have defended their doctoral theses.

TURNOVER AND RESULTS

Net turnover during the year totalled SEK 27.2 million (SEK 31.6 m), a fall of 14 per cent. Operating expenses during the interim period fell to SEK -36.8 million (SEK -39.0 m). Probi reported a loss after tax for the full year of SEK -8.8 million (SEK -6.7 m).

The reduction in turnover is primarily due to the fact that the periodisation of the initial licensing income from Danone has ceased and that Skane Dairy has wound up its sales in the UK.

The Functional Food business area has reported lower income for the reasons already mentioned, and this has resulted, among other things, in the operating profit/loss for the full year falling to SEK -0.4 million (SEK 5.8 m). The Dietary Supplements business area reports an operating loss of SEK -1.2 million (SEK -1.2 m). The Clinical Nutrition business area has not issued any invoices to date and the operating costs for the year are thus the same as the operating loss, namely SEK -7.7 million (SEK -5.8 m).

CASH FLOW AND FINANCIAL POSITION

Probi's cash flow for the year was SEK -7.2 million (SEK 26.8 m). The cash flow from operating activities totalled SEK -4.9 million (SEK -3.8 m). The increase in operating receivables during the reporting period affected the cash flow to the tune of SEK -0.5 million (SEK 1.0 m). Investments in patents have increased in conjunction with the interesting research findings with commer-

cial potential obtained by Probi. Liquid assets at the end of the reporting period totalled SEK 39.7 million (SEK 46.9 m).

Probi invests significant amounts in research and development, and the company has therefore reported a loss. R&D expenses, excluding raw materials and consumables, comprised 51 per cent (46 per cent) of total costs during the reporting period in question.

The company's accumulated fiscal loss on 31st December 2005 is SEK 66.6 million. The accumulated loss entails a deferred tax receivable of SEK 18.7 million, which can be utilised in future once the company starts reporting a profit. The company has valued this deferred tax receivable at zero.

There are no undertakings in respect of former Board Members or senior executives. The company was not involved in any legal proceedings in 2005.

EVENTS AFTER THE CLOSING DATE

No significant events have occurred after the closing date.

FUTURE DEVELOPMENT

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

ENVIRONMENTAL IMPACT

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

SUBSIDIARIES

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

PROPOSED ALLOCATION OF LOSS

The Board of Directors and the CEO propose that the Parent Company's accumulated loss of - SEK 8,883 thousand be offset in its entirety against the share premium reserve. According to the consolidated balance sheet, the Group's accumulated loss totals SEK -67,800 thousand.

CORPORATE GOVERNANCE

The Board of Directors and its rules of procedure

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

Composition of the Board

Probi's Board of Directors is appointed once a year at the Annual General Meeting. The Board of Directors for 2005 comprised six ordinary Members: Peter Zakrisson, Rolf Bjerndell, Mats Lidgard, Berthold Lindqvist and Göran Molin. Hilde Furberg replaced Birgit Stattin-Norinder, who resigned her seat on the Board in conjunction with the Annual General Meeting held in May 2005.

The Chairman of the Board, Peter Zakrisson, is also a partner in Probi's largest owner, H&B Capital. Board Member Rolf Bjerndell was, until 2005, the CEO of the second largest owner, Skane Dairy. No Board Member is employed by the company. The company's CEO and the Controller and Head of Administration also attend the majority of Board Meetings, although they are not entitled to vote.

Remuneration to the Board of Directors and management

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

The Directors' fees for 2005 were set at SEK 650 thousand, SEK 150 thousand of which is payable to the Chairman of the Board, while SEK 100 thousand is payable to each of the other Board Members. See Note 9 for details of remuneration paid to the Board.

The working procedures of the Board of Directors

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

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

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

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

Pursuant to the Articles of Association, the Board of Directors shall hold at least five ordinary Meetings per year, over and above the statutory company meeting. In 2005, the Board has held nine meetings and has focused particularly on following up on Danone's launch-related activities and the start of Rosell's launches in the Dietary Supplements sector, as well as on monitoring the company's efforts to commercialise the Clinical Nutrition business area.

Audit Committee

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

Remuneration Committee

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

Nomination Committee

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

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

Ownership structure

According to VPC (the Swedish CSD), Probi had 4,654 shareholders (5,297) on 30th December 2005. The company's share is quoted on the O-list of the Stockholm Stock Exchange. The company currently has no outstanding conversion loans or outstanding warrants.

Financial statements

Income statement

SEK thousand	Note	The Group		The Parent Company	
		2005	2004	2005	2004
Operating income	2, 4				
Net turnover	6	27,236	31,619	27,263	31,619
Change in stock in trade		-344	78	-344	78
Other income		430	218	430	218
Total operating income and changes in stock in trade	5,27	27,322	31,915	27,322	31,915
Operating expenses					
Raw materials and consumables		-1,247	-956	-1,247	-956
Staff overheads	9	-15,004	-14,298	-15,004	-14,298
Other costs	7, 8	-14,660	-17,494	-14,660	-17,494
Depreciation and write-downs of fixed assets	10, 15, 17, 18	-5,910	-6,255	-5,910	-6,255
Total operating expenses		-36,821	-39,003	-36,821	-39,003
Operating result		-9,499	-7,088	-9,499	-7,088
Result from financial investments					
Interest income	11	810	577	810	577
Interest expenses	11	-144	-164	-144	-164
Total result from financial investments		666	413	666	413
Result before tax		-8,833	-6,675	-8,833	-6,675
Tax on the result for the year	12	0	0	0	0
Net result for the year		-8,833	-6,675	-8,833	-6,675
No. shares at year-end		9,365,300	9,365,300		
EPS, SEK		-0.94	-0.71		

The company currently has no outstanding conversion loans or outstanding warrants.

Balance sheet

THE GROUP

SEK thousand	Note	The Group	
		2005	2004
Assets	5		
Fixed assets			
Intangible fixed assets			
Patents, licenses and similar rights	15	27,569	29,898
Goodwill	16	2,762	2,762
		30,331	32,660
Tangible fixed assets			
Buildings and land	17	3,956	4,117
Inventories, tools and installations	18	3,899	5,192
		7,855	9,309
Total fixed assets		38,186	41,969
Current assets			
Stock in trade, etc.			
Finished goods		1,040	1,384
Total stock in trade		1,040	1,384
Current receivables			
Accounts receivable	20	3,053	2,528
Prepaid costs and accrued income	21	963	956
Total current receivables		4,016	3,484
Liquid assets	22	39,702	46,924
Total current assets		44,758	51,792
Total assets		82,944	93,761

SEK thousand	Note	The Group	
		2005	2004
Liabilities and shareholders' equity	5		
Shareholders' equity	23		
Share capital		46,827	46,827
Other capital contributed		96,540	96,540
Loss brought forward		-67,800	-58,967
Total shareholders' equity		75,567	84,400
Long-term liabilities			
Other long-term liabilities		3,610	3,781
Total long-term liabilities	24	3,610	3,781
Current liabilities			
Current part of long-term liability		152	137
Accounts payable		1,051	1,953
Other liabilities		687	502
Accrued costs and prepaid income	25	1,877	2,988
Total current liabilities		3,767	5,580
Total shareholders' equity & liabilities		82,944	93,761
Pledged assets	26	4,100	4,100
Contingent liabilities		None	None

Balance sheet

THE PARENT COMPANY

SEK thousand	Note	The Parent Company	
		2005	2004
Assets	5		
Fixed assets			
Intangible fixed assets			
Patents, licenses and similar rights	15	27,569	29,898
		27,569	29,898
Tangible fixed assets			
Buildings and land	17	3,956	4,117
Inventories, tools and installations	18	3,899	5,192
		7,855	9,309
Financial fixed assets			
Participations in Group companies	19	4,031	4,031
Total fixed assets		39,455	43,238
Current assets			
Stock in trade, etc.			
Finished goods		1,040	1,384
Total stock in trade		1,040	1,384
Current receivables			
Accounts receivable	20	3,053	2,528
Prepaid costs and accrued income	21	963	956
Total current receivables		4,016	3,484
Liquid assets	22	39,702	46,924
Total current assets		44,758	51,792
Total assets		84,213	95,030

SEK thousand	Note	The Parent Company	
		2005	2004
Liabilities and shareholders' equity	5		
Shareholders' equity	23		
Restricted equity			
Share capital		46,827	46,827
Restricted reserves		0	40,672
Statutory reserve		34,807	60
Total restricted equity		81,634	87,559
Profit/loss brought forward		0	750
Net result for the year		-8,833	-6,675
Total loss brought forward		-8,833	-5,925
Total shareholders' equity		72,801	81,634
Long-term liabilities			
Other long-term liabilities		3,610	3,781
Liabilities to Group companies		4,035	4,035
Total long-term liabilities	24	7,645	7,816
Current liabilities			
Current part of long-term liability		152	137
Accounts payable		1,051	1,953
Other liabilities		687	502
Accrued costs and prepaid income	25	1,877	2,988
Total current liabilities		3,767	5,580
Total shareholders' equity & liabilities		84,213	95,030
Pledged assets	26	4,100	4,100
Contingent liabilities		None	None

Changes in shareholders' equity

The Group

SEK thousand	Share capital	Other capital contributed	Loss brought forward	Total shareholders' equity
Opening balance, 1st Jan 2004	41,113	70,270	-53,042	58,341
New share issue	5,714	31,427		37,141
New share issue costs		-5,157		-5,157
VAT reversed			750	750
Net result for the year			-6,675	-6,675
Opening balance, 1st Jan 2005	46,827	96,540	-58,967	84,400
Net result for the year			-8,833	-8,833
Shareholders' equity, 31st Dec 2005	46,827	96,540	-67,800	75,567

The Parent Company

SEK thousand	Share capital	Premium reserve	Statutory reserve	Non-restricted equity	Total shareholders' equity
Opening balance, 1st Jan 2004	41,113	21,891	60	-7,489	55,575
New share issue	5,714	31,427			37,141
New share issue costs		-5,157			-5,157
VAT reversed				750	750
Allocation of previous year's result		-7,489		7,489	0
Net result for the year				-6,675	-6,675
Opening balance, 1st Jan 2005	46,827	40,672	60	-5,925	81,634
Transfer from premium reserve to statutory reserve		-40,672	40,672		0
Allocation of previous year's result			-5,925	5,925	0
Net result for the year				-8,833	-8,833
Shareholders' equity, 31st Dec 2005	46,827	0	34,807	-8,833	72,801

There are a total of 9,365,300 shares with a no-par value of SEK 5.

The "VAT reversed" item refers to a deduction claimed in respect of the new share issue in 2000, which was granted in its entirety.

Cash flow statement

SEK thousand	The Group		The Parent Company	
	2005	2004	2005	2004
Operating activities				
Result before tax	-8,833	-6,675	-8,833	-6,675
Depreciation and write-downs	5,910	6,255	5,910	6,255
Cash flow from operating activities before changes in operating capital	-2,923	-420	-2,923	-420
Change in stock in trade	344	-78	344	-78
Change in operating receivables	-532	1,042	-532	1,042
Change in operating liabilities	-1,813	-4,393	-1,813	-4,393
Cash flow from operating activities	-4,924	-3,849	-4,924	-3,849
Investment activities				
Acquisition of intangible fixed assets	-2,022	-792	-2,022	-792
Acquisition of tangible fixed assets	-105	-1,145	-105	-1,145
Cash flow from investment activities	-2,127	-1,937	-2,127	-1,937
Financing activities				
Amortisation	-171	-137	-171	-137
VAT reversed	0	750	0	750
New share issue	0	31,984	0	31,984
Cash flow from financing activities	-171	32,597	-171	32,597
Change in liquid assets	-7,222	26,811	-7,222	26,811
Opening liquid assets	46,924	20,113	46,924	20,113
Closing liquid assets	39,702	46,927	39,702	46,924
Interest received and paid				
Interest income, as per income statement	810	577	810	577
Interest expense, as per income statement	-144	-164	-144	-164

No prepaid or accrued interest effects affect the interest income and interest expenses reported above.

Notes to the accounts

NOTE 1 GENERAL INFORMATION

Probi was founded in 1991 and is now a leading player in the field of probiotic research and development. The company's research relates to live microorganisms with scientifically demonstrated health-giving effects. The main fields of research are: Gastrointestinal complaints, Immunology, Risk factors for cardiovascular disease, and Stress and performance recovery.

Probi's business concept is based on offering effective and well-documented probiotic product concepts with extensive patent protection, thereby creating the potential for higher royalties than in the industry as a whole.

The Group comprises the Parent Company, Probi AB, and two dormant subsidiaries, Probi Food AB and Probi Feed AB.

Probi's share has been quoted on the O-list of the Stockholm Stock Exchange since December 2004.

These consolidated accounts were approved by the Board of Directors for publication on 24th February 2006.

NOTE 2 ACCOUNTING AND VALUATION PRINCIPLES

The consolidated accounts have been prepared in accordance with the provisions of the Swedish Annual Accounts Act, International Financial Reporting Standards (IFRS) and interpretative statements by the International Financial Reporting Interpretations Committee (IFRIC), as approved by the European Commission. The consolidated accounts are also covered by IFRS 1 "First time adoption" in that these are the first consolidated accounts to be drawn up in accordance with IFRS, as approved by the European Commission. Recommendation RR 30, Complementary accounting regulations for corporate groups, issued by the Swedish Financial Accounting Standards Council, has also been applied. Note 29 contains details of the way in which the transition to IFRS has affected the Group's result and financial position.

2.1 Prerequisites for preparing the consolidated financial reports

The Parent Company's functional currency is the Swedish krona, which is also the reporting currency for both the Parent Company and the Group. Unless otherwise indicated, all amounts shown have been rounded off to the nearest thousand kronor (SEK). The consolidated accounts have been prepared in accordance with the acquisition value accounting method, with the exception of applicable cases where financial assets are valued at their true value.

The most important accounting principles applied when these consolidated accounts were prepared are shown below. These principles have been applied consistently for all the years presented, unless otherwise indicated.

The company has applied IAS 32 and IAS 39 as of 1st January 2005. The application of IAS 32 did not entail any changes to accounting principles, simply expanding the information requirement. These standards will therefore be applied in future, in accordance with the decision by the company not to apply the above-mentioned standards for the comparison year of 2004.

The application of IAS 39 has entailed a change to the accounting principles in respect of financial instruments. The effect of the application of IAS 39 is presented in Note 29.

The Parent Company applies the same accounting principles, other than with regard to the exceptions and additions stipulated in recommendation RR 32, "Accounting for legal entities", issued by the Swedish Financial Accounting Standards Council. The accounting principles for the Parent company are detailed in the section entitled "The Parent Company's accounting principles".

2.2 Consolidated accounts

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

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

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

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

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

2.3 Segment classification

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

2.4 Income

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

Interest income is reported in accordance with effective yield.

2.5 Loan costs

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

2.6 Income tax

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

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

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

2.7 Intangible assets

Goodwill: Goodwill comprises the amount by which the acquisition value exceeds the true value of the Group's participation in the acquired subsidiary's net assets at the time of the acquisition. Write-down tests (also known as impairment tests) are performed annually to determine whether any requirement for write-downs exists.

Accounting principles in respect of research and development expenses: Research expenses are booked as expenses on a rolling basis. Development expenses are reported as assets from the date when it is deemed that the project or activity

to which they relate will lead to a technically and commercially launchable product and where Probi has decided to seek a partner or in some other way attempt to launch the product. The company conducts research and development work in the probiotics field. Probi's licensees use this probiotic in their own products and these are in turn further developed for launch and commercial use. Probi provides assistance, but is not the party that completes the development of the end-product.

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

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

– Patents – 10 years

– Licenses – 12 years, in respect of acquisitions of European rights where the initial contractual period is 12 years.

Annual charges and other additional fees are booked as costs on a rolling basis.

The useful life of the assets is reviewed annually.

Write-downs of intangible assets: Assets with an indeterminate useful life are not amortised; rather, they are reviewed annually with regard to any requirement for write-downs. Assets that are amortised are evaluated with regard to a reduction in value whenever events or changes in circumstances indicate that the reported value may not be recoverable. A write-down is effected in the amount by which the asset's reported value exceeds its recovery value. The recovery value is whichever is the higher of an asset's true value less sales costs and the useful value. When assessing write-down requirements, assets are grouped at the lowest levels at which separate identifiable cash flows exist (cash-generating units).

2.8 Tangible fixed assets

Tangible fixed assets are reported at the acquisition value less depreciation. Additional charges are only added to the reported value of the asset or reported as a separate asset, depending on what is appropriate, when it is likely that the future economic benefits associated with the asset will accrue to the Group and the acquisition value of the asset can be measured in a reliable way. Expenses incurred in conjunction with repairs and maintenance are reported as costs. Tangible fixed assets are depreciated systematically over the estimated useful life of the asset. Linear depreciation methods are used for all types of tangible asset. The following depreciation periods are applied:

– Buildings – 25 years

– Inventories, tools and installations – 3–10 years

The useful life of the assets is reviewed annually.

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

2.9 Leasing

Leasing agreements are classified within the Group as either financial or operational leasing. Leasing agreements in respect of fixed assets whereby the Group has, in every significant respect, assumed the same risks and enjoys the same benefits as it would in conjunction with direct ownership, are classified as financial leasing.

Operational leasing agreements: Leasing of fixed assets where the lessor, in every significant respect, continues to hold the title to the asset, are classified as operational leasing. The leasing charge for operational leasing is carried as an expense linearly over the leasing period.

Financial leasing agreements: When the leasing agreement results in the Group, in its capacity as lessee, in every significant respect enjoys the economic benefits and assumes the economic risks attributable to the leasing object, the object is

reported as a fixed asset in the consolidated balance sheet. A corresponding undertaking to pay leasing charges in the future is reported as a liability. All leasing agreements, irrespective of whether they are operational or financial, are reported in the Parent Company as rental agreements (operational leasing agreements).

All of the company's leasing agreements are operational in nature.

2.10 Financial instruments

Consolidated financial instruments reported in the balance sheet include liquid assets, accounts receivable and accounts payable, as well as loan liabilities.

Accounts receivable: Accounts receivable are non-derivative financial assets with fixed or fixable payments that are not quoted on an active market. They are distinguished by the fact that they arise when the Group supplies monies, goods or services directly to a customer without intending to trade in the receivable that arises. They are included under Current assets, with the exception of items with a due date that falls more than 12 months after the closing date, which are classified as Fixed assets. Accounts receivable are booked under the Accounts receivable item in the balance sheet. Accounts receivable are booked in the amount that the Group expects to receive, based on an individual assessment of doubtful accounts receivable.

Loan costs: Loan costs are initially reported in the amount received after deductions for transaction costs. If the reported amount differs from the amount to be repaid on the due date, the difference is periodised over the duration of the loan as interest expenses or interest income. This ensures that on the due date, the reported amount corresponds to the amount to be repaid. Financial liabilities do not cease to be reported until the debts have been settled by means of repayment or the loan being remitted. All transactions are reported on the settlement date.

2.11 Stock in trade

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

The acquisition value of finished goods comprises the cost of raw materials, direct salaries, other direct costs and indirect manufacturing costs attributable to them (based on normal manufacturing capacity). Loan costs are not included. The net sales value comprises the estimated sale price in the day-to-day operations, less applicable floating sales overheads.

2.12 Accounts receivable

Accounts receivable are reported at their true value, less any provision for depreciation. Provision for the depreciation of accounts receivable is made when there is objective proof that the Group will be unable to obtain the full amount due in accordance with the original terms of the receivable. The size of the provision is determined by the difference between the reported value of the asset and the current value of estimated future cash flows, discounted using the effective interest rate. The provision amount is reported in the income statement.

2.13 Liquid assets

Liquid assets comprise cash and bank balances.

2.14 Foreign currencies

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

2.15 Provisions

Provisions are reported when the Group has, or may be deemed to have, an obligation as a result of events that have occurred, and where it is likely that disbursements will be required in order to meet the obligation. A further requirement is that it is possible to make a reliable estimate of the amount to be disbursed.

Provision for potential restructuring measures is made once a detailed, formal plan for the measures has been drawn up and well-founded expectations have been generated among those who will be affected by the measures.

2.16 Pensions

All of the company's pension plans are defined contribution plans. Under defined contribution plans, the company's legal or informal obligations are limited to the size of the contribution that the company agrees to make. The Group's disbursements in respect of defined contribution plans are reported as a cost over the period during which the employees performed the services to which the contribution relates.

2.17 Cash flow statement

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

2.18 The Group

As of 1st January 2005, Probi prepares its consolidated accounts in accordance with the International Financial Reporting Standards (IFRS) approved by the European Commission. The Interim Report for the first quarter of 2005 was the first to be submitted by the company in accordance with IFRS, and was prepared in accordance with IAS 34 "Interim financial reporting".

2.19 The Parent Company's accounting principles

The Parent Company's financial reports have been prepared in accordance with the provisions of the Swedish Annual Accounts Act (ÅRL) and recommendation RR32, Reporting for legal entities, of the Swedish Financial Accounting Standards Council, whereby the Parent Company shall, wherever possible within the framework of ÅRL and taking into account the link between reporting and taxation, apply the International Financial Reporting Standards (IFRS) approved by the EU. No differences between the reporting of the Parent Company and the Group have been identified.

NOTE 3 FINANCIAL RISK FACTORS

Probi's partnerships with international customers entail income in several different currencies that are affected by exchange rate fluctuations. Revenues from Skane Dairy currently dominate, and contractually, these are always paid in SEK, irrespective of whether they derive from royalties in the Nordic region or the UK. In 2004, a smaller percentage of revenues were in EUR, but as the agreements with Danone and Institut Rosell generate royalty payments, revenues in foreign currencies are expected to increase.

Probi has borrowed approximately SEK 3.8 million on the production facility in Sösdala at a variable interest rate. An increase of 1 per cent in the interest rate would mean an increase of approximately SEK 40,000 in interest expenses. The company has no interest-bearing operating liabilities.

NOTE 4 IMPORTANT ESTIMATES AND ASSESSMENTS FOR ACCOUNTING PURPOSES

Probi's deferred tax receivable attributable to fiscal deficit deductions has not been reported, pending product launches arising from new agreements and the company's ability to generate a taxable profit.

NOTE 5 SEGMENT INFORMATION

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

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

"Other" comprises unallocated research and business development costs, general administrative costs, other central costs, and financial items.

There are no sales or other transactions between the various lines of business.

Income statement per line of business

The Group

2005	FF	DS	CN	Other	Total
Total operating income	24,143	3,517	0	6	27,666
Total operating expenses	-24,495	-4,755	-7,738	-177	-37,165
Operating result	-352	-1,238	-7,738	-171	-9,499

2004

Total operating income	29,611	2,008	0	218	31,837
Total operating expenses	-23,791	-3,222	-5,769	-6,143	-38,925
Operating result	5,820	-1,214	-5,769	-5,925	-7,088

Balance sheet per line of business

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

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

Balance sheet per line of business

The Group

2005	FF	DS	CN	Other	Total
Total assets	37,598	1,533	1,769	42,044	82,944
Long-term liabilities	0	0	0	3,610	3,610
Current liabilities	885	12	282	2,588	3,767
Total liabilities	885	12	282	6,198	7,377
Shareholders' equity	0	0	0	0	75,567
Investments	2,022	0	45	60	2,127
Depreciations and amortisation	-5,055	-217	-461	-177	-5,910

2004

	FF	DS	CN	Other	Total
Total assets	41,306	951	2,068	49,436	93,761
Long-term liabilities	0	0	0	3,781	3,781
Current liabilities	2,416	489	106	2,569	5,580
Total liabilities	2,416	489	106	6,350	9,361
Shareholders' equity	0	0	0	0	84,400
Investments	958	0	979	0	1,937
Depreciations and amortisation	-5,238	-251	-528	-238	-6,255

Operating income, assets and investments broken down by geographical area

The Group

2005	Nordic region	Europe, other	Global, other	Total
Operating income	20,815	4,131	2,720	27,666
Assets	54,923	25,377	2,644	82,944
Investments	485	624	1,018	2,127

2004

Operating income	20,783	9,046	2,008	31,837
Assets	63,693	29,636	432	93,761
Investments	933	885	119	1,937

The Parent Company

2005	Nordic region	Europe, other	Global, other	Total
Operating income	20,815	4,131	2,720	27,666
Assets	56,192	25,377	2,644	84,213
Investments	485	624	1,018	2,127
2004				
Operating income	20,783	9,046	2,008	31,837
Assets	64,962	29,636	432	95,030
Investments	933	885	119	1,937

NOTE 6 BREAKDOWN OF NET TURNOVER

	The Group		The Parent Company	
	2005	2004	2005	2004
Goods	2,086	1,667	2,086	1,667
Royalties, licenses, etc.	25,150	29,952	25,150	29,952
Total	27,236	31,619	27,236	31,619

NOTE 7 AUDITORS' FEES (ÖHRLINGS PRICEWATERHOUSECOOPERS)

	The Group		The Parent Company	
	2005	2004	2005	2004
Audits	342	249	342	249
Non-audit assignments	38	673	38	673
Total	380	922	380	922

NOTE 8 RESEARCH AND DEVELOPMENT

	The Group		The Parent Company	
	2005	2004	2005	2004
Research and development expenses booked as costs	15,240	14,692	15,240	14,692

NOTE 9 AVERAGE NUMBER OF EMPLOYEES, SALARIES, OTHER REMUNERATION AND PAYROLL OVERHEADS

	The Group		The Parent Company	
	2005	2004	2005	2004
Average no. of employees				
Women	10	9	10	9
Men	8	8	8	8
Total	18	17	18	17

Salaries and remuneration

The Board of Directors and CEO	2,095	2,208	2,095	2,208
Other management	2,589	2,807	2,589	2,807
Other employees	5,032	4,380	5,032	4,380
Total	9,716	9,395	9,716	9,395

Payroll overheads, total:

Of which pension costs for the Board and CEO	478	358	478	358
Of which pension costs for other management personnel	610	597	610	597
Of which pension costs for other employees	481	352	481	352

The Group The Parent Company

	2005	2004	2005	2004
Salary and pension premiums for the CEO:				
Salary	1,485	1,663	1,485	1,663
Pension premiums	487	358	478	358
Salaries and remuneration for the Board:				
Salary and remuneration for the Chairman of the Board	142	165	142	165
Salaries and remuneration for other Board Members	468	380	468	380

Salary payments made to the CEO of the company in 2005 totalled SEK 1,485 thousand. The company has also paid SEK 478 thousand in pension premiums for the CEO. There is currently no bonus programme for the CEO and other senior executives. The period of notice for the CEO is six months if notice is given by the CEO and twelve months if notice is given by the company. Severance pay shall also be payable in the sum of twelve months' salary when notice is given by the company. The retirement age for the CEO is 65. The period of notice for other senior executives is six months if notice is given by Probi and three months if notice is given by the employee.

The company has no severance pay or pension agreements other than those described above.

The CEO's salary is set by the Board of Directors while those of the rest of the management are set by the CEO and the Chairman of the Board.

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

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

Absence due to sickness

	The Parent Company	
	2005	2004
Total absence due to sickness	0.9%	1.0%

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

NOTE 10 DEPRECIATION AND WRITE-DOWNS OF FIXED ASSETS

Tangible and intangible fixed assets have been depreciated in the amounts shown below:

	The Group		The Parent Company	
	2005	2004	2005	2004
Depreciation and write-downs	5,910	6,255	5,910	6,255

NOTE 11 FINANCIAL INCOME AND EXPENSES

	The Group		The Parent Company	
	2005	2004	2005	2004
Interest income	810	577	810	577
Interest expenses	-144	-164	-144	-164

NOTE 12 INCOME TAX

Tax is calculated at a tax rate of 28 per cent.

	2005	2004
Result before tax	-8,833	-6,675
Fiscal effect, calculated at the national tax rate	-2,473	-1,869
Non-taxable income	0	-62
Non-deductible expenses	12	12
Fiscal deficit for which no deferred tax receivable has been reported	2,461	1,919
Tax expense	0	0

NOTE 13 DEFERRED TAX

	The Group		The Parent Company	
	2005	2004	2005	2004
Non-booked tax receivable in respect of unutilised deficit deductions	18,654	16,193	18,654	16,193

There is no time limit on the use of the non-booked tax receivable in respect of unutilised deficit deductions. On 31st December 2005, Probi had SEK 66.2 million in unutilised deficit deductions, corresponding to an as yet unbooked deferred tax receivable of SEK 18.7 million. Probi will consequently have a corresponding deduction entitlement when the company shows a profit. Probi's ability to realise all or part of the value of the loss deduction depends on the company's ability to generate taxable profits.

NOTE 14 OPERATIONAL LEASING AGREEMENTS

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

	The Group		The Parent Company	
	2005	2004	2005	2004
Falls due for payment within one year	1,910	1,900	1,910	1,900
Falls due for payment after more than 1 but fewer than 5 years	182	1,870	182	1,870
Falls due for payment after more than 5 years	-	-	-	-

NOTE 15 PATENTS, LICENSES AND SIMILAR RIGHTS

Patents and licenses	The Group		The Parent Company	
	2005	2004	2005	2004
Opening acquisition value	51,730	50,938	51,730	50,938
New acquisitions	2,022	792	2,022	792
Disposals	-237	0	-237	0
Closing accumulated acquisition value	53,515	51,730	53,515	51,730
Opening depreciation	-21,832	-17,298	-21,832	-17,298
Disposals	83	0	83	0
Depreciation for the year	-4,197	-4,534	-4,197	-4,534
Closing accumulated depreciation	-25,946	-21,832	-25,946	-21,832
Closing residual value according to plan	27,569	29,898	27,569	29,898

Patents, licenses and similar rights are primarily attributable to the buy-back of the European rights from Skane Dairy for SEK 40 million in 2001, the book value of which, as on 31st December 2005, was SEK 23.8 million. The European rights are depreciated linearly from the acquisition year up until 2012, which is the year when the patent for the bacterial strain in question expires.

Write-down tests (or impairment tests) have been carried out within Probi during 2005 to determine the value of patents, licenses and similar rights, both on 31st December 2004 and on 31st December 2005.

Probi monitors its partners' launches, and their development work and product positionings for impending launches, closely. The information obtained from this material forms the basis for the information used when the company performs write-down tests. The tests carried out have indicated that no write-down requirement exists. The discount rate used was 12 per cent.

NOTE 16 GOODWILL

Goodwill	The Group		The Parent Company	
	2005	2004	2005	2004
Opening acquisition value	2,762	2,762	-	-
Closing residual value according to plan	2,762	2,762	-	-

The goodwill item is related to the strategic acquisition in 1998 of outstanding shares in Probi Food AB.

Goodwill is tested every year with regard to any write-down requirement, as of the 2004 financial year. Such tests are also conducted when there are indications of a write-down requirement. The Group has reviewed the useful life of its intangible assets in accordance with the provisions of IAS 38. This process has not occasioned any adjustments.

The Group carries out tests every year to determine whether any write-down requirement exists for goodwill, in accordance with the accounting principle described in Note 2.7. The recovery value of cash-generating units has been determined by calculating the value in use. Certain estimates must be made for the purposes of these calculations. The remaining useful life is 7 years (8), 12 per cent (12 per cent) has been used as the discount rate, and growth has been calculated at 10 per cent (10 per cent), which was also the growth rate reported for the license agreement in question in 2005.

Write-down tests have been carried out within Probi during 2005 to determine the goodwill value, both on 31st December 2004 and on 31st December 2005. The tests carried out have indicated that no write-down requirement exists.

NOTE 17 BUILDINGS AND LAND

Buildings and land	The Group		The Parent Company	
	2005	2004	2005	2004
Opening acquisition value	4,642	4,642	4,642	4,642
Closing accumulated acquisition value	4,642	4,642	4,642	4,642
Opening depreciation	-525	-364	-525	-364
Depreciation for the year	-161	-161	-161	-161
Closing accumulated depreciation	-686	-525	-686	-525
Closing residual value according to plan	3,956	4,117	3,956	4,117
Rateable value, land in Sweden	561	561	561	561
Rateable value, buildings in Sweden	1,339	1,339	1,339	1,339

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

An independent valuation in 2004 indicates that the market value of buildings and land exceeds the book value.

NOTE 18 INVENTORIES, TOOLS AND INSTALLATIONS

	The Group		The Parent Company	
	2005	2004	2005	2004
Inventories				
Opening acquisition value	13,164	12,019	13,164	12,019
Purchases	105	1,145	105	1,145
Closing accumulated acquisition value	13,269	13,164	13,269	13,164
Opening depreciation	-7,972	-6,412	-7,972	-6,412
Depreciation for the year	-1,398	-1,560	-1,398	-1,560
Closing accumulated depreciation	-9,370	-7,972	-9,370	-7,972
Closing residual value according to plan	3,899	5,192	3,899	5,192

NOTE 19 PARTICIPATIONS IN GROUP COMPANIES

	The Parent Company	
	2005	2004
At start of year	4,031	4,031
New acquisitions	-	-
Book value	4,031	4,031

Specification of the Parent Company's shareholdings in Group companies

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

No purchases or sales have been made between the Group's companies during the year.

NOTE 20 ACCOUNTS RECEIVABLE

Probi's accounts receivable are related to a few major licensing partners. The company does not deem there to be any significant credit risk in respect of these partners. Probi has used letters of credit or payment in advance when selling to companies without licensing agreements. None of the accounts receivable have been deemed doubtful.

NOTE 21 PREPAID COSTS AND ACCRUED INCOME

	The Group		The Parent Company	
	2005	2004	2005	2004
Prepaid rent	437	428	437	428
Other items	526	528	526	528
Total	963	956	963	958

NOTE 22 LIQUID ASSETS

The Group's liquid assets refer to cash and bank balances.

NOTE 23 SHAREHOLDERS' EQUITY

A specification of changes in shareholders' equity can be found in the report entitled "Changes in shareholders' equity", which follows directly on the balance sheets.

Number of shares	Class A	Class B	Common shares class	Total number
Number on 1st Jan. 2004	7,870,312	33,242,188		41,112,500
Reverse split, 5:1, and one share class			8,222,500	8,222,500
New issue with preferential rights			1,142,800	1,142,800
Number on 31st Dec. 2004			9,365,300	9,365,300
Number on 31st Dec. 2005			9,365,300	9,365,300

The no-par value of the shares is SEK 5.

NOTE 24 OTHER LONG-TERM LIABILITIES

	The Group		The Parent Company	
	2005	2004	2005	2004
Liabilities to credit institutions, 1-5 years	608	546	608	546
Liabilities to credit institutions, >5 years	3,002	3,235	3,002	3,235
Liabilities to Group companies, >5 years	-	-	4,035	4,035
Total	3,610	3,781	7,645	7,816

Liabilities refer to variable interest rate loans for industrial premises.

NOTE 25 ACCRUED COSTS AND PREPAID INCOME

	The Group		The Parent Company	
	2005	2004	2005	2004
Accrued holiday pay	222	189	222	189
Social security contributions	358	311	358	311
Periodised licensing revenues	-	1,810	-	1,810
Other items	1,297	678	1,297	678
Total	1,877	2,988	1,877	2,988

NOTE 26 PLEDGED ASSETS AND CONTINGENT LIABILITIES

	The Group		The Parent Company	
	2005	2004	2005	2004
Real estate mortgages	3,300	3,300	3,300	3,300
Floating charges	800	800	800	800
Total pledged assets	4,100	4,100	4,100	4,100

The company has no contingent liabilities.

NOTE 27 TRANSACTIONS WITH ASSOCIATED COMPANIES

Transactions with associated companies reported in the income statement:

	The Group		The Parent Company	
	2005	2004	2005	2004
Skane Dairy (goods)	-	725	-	725
Skane Dairy (royalty revenues)	22,166	24,268	22,166	24,268
Total income	22,166	24,993	22,166	24,993
Skane Dairy (royalty costs)	-107	-321	-107	-321
H&B Capital Advisers AB (fee)	-	-93	-	-93
H&B Capital Advisers AB (reimbursement of expenses)	-367	-178	-367	-178
GMF AB	-114	-158	-114	-158
Total costs	-588	-750	-588	-750

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

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

NOTE 28 EVENTS AFTER THE CLOSING DATE

No significant events have occurred after the closing date.

NOTE 29 TRANSITION TO IFRS

Probi's financial reports have been prepared in accordance with IFRS since 1st January 2005. The transition to IFRS is reported in accordance with IFRS 1, "First-time adoption of International Financial Reporting Standards", in which context the transition date is 1st January 2004. Under IFRS 1, the comparison year of 2004 shall also be reported in accordance with IFRS. No adjustment will be made for financial years preceding 2004, which is in compliance with the transition regulations contained in IFRS 1.

Swedish accounting practice has gradually moved closer to the IFRS rules, but the transition to reporting in accordance with IFRS does entail some changes. The following description reveals the areas deemed to have a significant effect on Probi's shareholders' equity and income statement for the 2004 year. This description has been drawn up in accordance with the principles applied as of 31st December 2005.

The most significant changes for Probi are adaptations in line with IFRS 3, "Business combinations", which requires an end to the amortisation of goodwill and other intangible assets with an indeterminate useful life, which shall, instead, be tested annually for any write-down requirement. As a consequence of the transition to IFRS, the goodwill amortisation, totalling SEK 0.7 million, effected in accordance with Swedish accounting principles in 2004 has been reversed. Probi has not identified any adjustments with regard to the opening balance on 1st January 2004.

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

The transition to IFRS is reported in accordance with IFRS 1, "First-time adoption of International Financial Reporting Standards". Under IFRS 1, the comparison year of 2004 shall also be reported in accordance with IFRS, and the adjustments for 2004 are shown below.

Consolidated income statement	2004		
	Operating resultat	Result before tax	Result for the year
Result in accordance with previously applied accounting principles	-7,779	-7,366	-7,366
Goodwill amortisation	691	691	691
Result in accordance with IFRS	-7,088	-6,675	-6,675
Change in shareholders' equity	2004-12-31		
Shareholders' equity in accordance with previously applied accounting principles	83,709		
Effect of transition to IFRS	691		
Shareholders' equity in accordance with IFRS	84,400		

The above bridges between previously applied accounting principles and IFRS have been structured in accordance with the principles applied as of 31st December 2005. The same accounting principles and calculation methods as those used for the most recent Annual Report have been applied, with the exception of the adaptations detailed above.

The income statement and the balance sheets will be submitted to the Annual General Meeting of the shareholders of the company for adoption on 9th May 2006.

Lund 24th February 2006

Peter Zakrisson
Chairman

Rolf Bjerndell

Hilde Furberg

Berthold Lindqvist

Mats Lidgard

Göran Molin

Per Bengtsson
CEO

Our Auditors' Report was submitted on 27th February 2006
Öhrlings PricewaterhouseCoopers AB

Lars Helgesen
Authorised Public Accountant
Principal Accountant

Magnus Jönsson
Authorised Public Accountant

Auditors' Report

**To the Annual General Meeting of the shareholders of Probi AB (publ),
Swedish Company Registration Number 556417-7540**

We have audited the annual accounts, the consolidated accounts, the accounting records and the administration of the Board of Directors and the CEO of Probi AB (publ) for the financial year 2005. These accounts and the administration of the company are the responsibility of the Board of Directors and the CEO, as is ensuring that the Swedish Annual Accounts Act is applied to the preparation of the annual accounts, and that IFRS international accounting standards, as adopted by the EU, and the Swedish Annual Accounts Act are applied to the preparation of the consolidated accounts. Our responsibility is to express an opinion on the annual accounts, the consolidated accounts and the administration based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Sweden. These standards require that we plan and perform the audit to obtain high, but not absolute, assurance that the annual accounts and the consolidated accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and their application by the Board of Directors and the CEO, as well as evaluating the significant estimates made by the Board of Directors and the CEO when preparing the annual accounts and the consolidated accounts, and evaluating the overall presentation of information in the annual accounts and the consolidated accounts. As a basis for our opinion concerning discharge from liability, we examined significant decisions, actions taken and circumstances of the company in order to be able to determine the liability, if any, to the company of any Board Member or the CEO. We also examined whether any Board Member or the CEO has, in any other way, acted in contravention of the Swedish Companies Act, the Swedish Annual

Accounts Act, or the Articles of Association. We believe that our audit provides a reasonable basis for our opinion as set out below.

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

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

Malmö, 27th February 2006

Öhrlings PricewaterhouseCoopers AB



Lars Helgesen
*Authorised Public Accountant
Principal Accountant*



Magnus Jönsson
Authorised Public Accountant

The Board of Directors



Peter Zakrisson

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



Rolf Bjerndell

Born in 1951. Member of the Board and Chairman of the Board between 1996 and 2000. Education: Business Administration degree from Lund University. CEO of Skane Dairy, 1994–2005. Other directorships: the Chamber of Commerce and Industry in Southern Sweden, Malmö Incubator AB, Swedish Oat Fibre AB, Ideon Agro Food, et al. Holding in the company: 6,775 shares.



Hilde Furberg

Born in 1958. Member of the Board since 2005. Education: B.Sc. in Medical Technology, University of Oslo. Vice President & General Manager of Nordic/Benelux Genzyme. Other directorships: none. Holding in the company: 0 shares.



Mats Lidgard

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



Berthold Lindqvist

Born in 1938. Member of the Board since 1998. Education: Engineer, Honorary Doctor of Medicine, Lund University, 1999. Vice President of Wilh. Sonesson AB, 1983-1984. President and CEO of Gambro AB, 1984-1998. Other directorships: Munters AB (Chairman), Securitas AB, Trelleborg AB, JM AB, Cardo AB, Novotek AB et al. Holding in the company: 57,500 shares.



Göran Molin

Born in 1949. Member of the Board since 1998. Education: Doctorate from the Royal College of Veterinary Surgeons in Stockholm in 1976. Reader in microbiology at Lund University, 1984. Professor of Food Hygiene at Lund University. Göran Molin was part of the group of researchers who founded Probi AB. Holding in the company: 438,241 shares.

Auditors

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

The senior management



Niklas Bjärum

Born in 1963. Head of Marketing and Sales.

Education: Degree in international economics from Lund University.

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

Holding in the company: 2,000 shares.

Jan Alenfall

Born in 1962. Assistant Head of Research and Development.

Education: Degree in Biochemistry. Doctorate in pharmacology from Lund University, specialising in the biology of tumours.

Background: Jan Alenfall has worked in the pharmaceutical industry for 14 years at Pharmacia, Ferring, Bioglan and Skye-Pharma. He was also part of the management group at the Swedish units of Bioglan and Skye-Pharma. Jan Alenfall took over as Assistant Head of Research and Development at Probi in April 2004, and is a member of the management group.

Holding in the company: 1,000 shares.

Per-Ola Forsberg

Born in 1961. CFO and Head of Administration.

Education: Degree in economics and business administration from Lund University.

Background: Per-Ola Forsberg was employed in November 2000 as CFO and Head of Administration. Immediately prior to this, Per-Ola Forsberg was the Controller at Rexam Beverage Can Fosite AB, and before that, he was employed as Head of Administration at PolyPeptide Laboratories (Sweden) AB (1994–1998).

Holding in the company: 5,400 shares and 20,000 stock options*.

Per Bengtsson

Born in 1954. CEO and Head of Research and Development.

Education: University medical degree from the Karolinska Institute. Registered physician. M.D. in cellular biology from Linköping University.

Background: Per Bengtsson took over as CEO in November 2003 and as Head of Research and Development in January of the same year. He has worked in the biotechnology and pharmaceutical industry for 15 years, most recently at Pharmacia AB as Head of Research for Plasma Products. Other companies in which Per Bengtsson has held senior positions include Ferring and Karo Bio.

Holding in the company: 17,500 shares and 40,000 stock options*.

* See also under Note 9 on page 37.

Glossary

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

Clinical documentation Documentation of clinical trials.

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

Clinical trials Studies of food or pharmaceutical products on humans.

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

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

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

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

ICU Intensive care unit.

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

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

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

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

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

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

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

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

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

The Annual General Meeting

The Annual General Meeting

The shareholders of Probi AB (publ) will be notified of the Annual General Meeting of the company's shareholders to be held on Tuesday 9th May 2006 at 3 p.m. (CET) at the Scandic Hotel Star Lund, at Glimmervägen 5, in Lund.

Entitlement to participate

In order to be entitled to participate in the Meeting, shareholders must both be registered in the Register of Shareholders maintained by VPC AB (the Swedish CSD) in respect of circumstances obtaining on Wednesday 3rd May 2006, and shall have notified Probi of their intention to participate in the Meeting no later than 4 p.m. (CET) on Wednesday 3rd May 2006.

Shareholders whose shares are nominee-registered must temporarily re-register their shares in their own name with VPC in order to be entitled to participate in the Meeting. Such registration must be effected no later than Wednesday 3rd May 2006, and shareholders must therefore notify the nominee of their request to that effect in good time.

Applications to participate

Applications to participate in the meeting shall be submitted in writing to Probi AB (publ.), Ideon, SE-223 70 Lund, Sweden, by fax on +46 (0)46 286 89 28, by phone on +46 (0)46 286 89 20 or by e-mail to probi@probi.se. Applications shall include the applicant's name, civic ID number or company registration number, the number of shares held, a daytime telephone number and, where relevant, the number of assistants (a maximum of two) who will accompany the applicant to the meeting. If a shareholder intends to be represented by a proxy, a power of attorney and other authorisation documents should be appended to the application.

Financial reporting dates

→ Interim Report, Q1	26th April
→ 2005 Annual General Meeting	9th May, 3 p.m. (CET)
→ Interim Report, Q2	25th July
→ Interim Report, Q3	24th October
→ Preliminary financial statement for 2006	14th February 2007
→ 2006 Annual General Meeting	8th May 2007

Probi AB

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