



Table of contents

6	Introduction
8	Letter from the Chairman of the Board and the Chief Executive Officer
10	Drug Candidate Portfolio
20	Research Portfolio
23	An Integrated R&D Organisation
28	Corporate Governance
54	Financial Review
58	Report of the Group Auditors
59	Consolidated Financial Statements
76	Report of the Statutory Auditors
77	Financial Statements of Basilea Pharmaceutica Ltd.
81	Contact Information





Introduction

Basilea Pharmaceutica Ltd., headquartered in Basel, Switzerland is a fully integrated research and development biopharmaceutical company, uniquely positioned with a portfolio of late stage compounds including those for the treatment of resistant bacteria and fungi. Basilea's vision is to be a leading biopharmaceutical company that discovers, develops and commercializes novel medicines for patients with high medical needs. The focus of the company to-date is on the areas of anti-bacterials, antifungals and dermatology.

Basilea has a broad and balanced late-stage biopharmaceutical development pipeline comprising two compounds currently in clinical phase III testing and an additional compound entering phase III. These products have clearly identifiable properties that offer potential advantages over existing treatments and hence may satisfy significant unmet medical needs.

Our leading antibacterial drug, ceftobiprole, is a broad-spectrum antibiotic effective against certain life-threatening drug-resistant bacteria. Ceftobiprole is being developed and commercialized globally with our partner Johnson & Johnson and is currently in phase III clinical trials. This product has "fast track" designation from the FDA identifying it as drug that can satisfy a high medical need. Complementing ceftobiprole, and intended to treat serious life-threatening fungal infections, is BAL8557, a potent broad-spectrum water-soluble antifungal drug. This product is entering phase III clinical trials. Our third late-stage development product in phase III clinical trials is alitretinoin; a vitamin A derivative intended to treat patients with chronic, severe hand dermatitis, who have not responded to topical therapies. There is currently no approved treatment for these patients.

In addition to the late stage development portfolio, Basilea has substantial research assets in terms of intellectual property, projects and libraries to generate an innovative product pipeline. In 2002, Basilea established a second research site near Shanghai in China that specializes in chemistry, to complement our first site established in 2000 in Basel, Switzerland. We employ 190 highly talented scientists and experienced healthcare professionals in Switzerland and China who conduct research, development and implement our business objectives worldwide.

Innovative and new medicines arise from commitment to research. The number of new drugs marketed and originating from focused biopharmaceutical companies steadily grows. Large pharmaceutical companies increasingly enter into partnerships with biopharmaceutical companies to complement their own pipelines.





From left: Mr. Werner Henrich | Dr. Anthony Man

Letter from the Chairman of the Board and the Chief Executive Officer

Dear Shareholders,

We are delighted to report upon yet another successful year of achievements. Basilea, now just over 5 years old, delivered once again on key milestones, building on our track record of operational performance. As a result, our products are marching closer to the marketplace.

The signature of a global collaboration on our leading innovative antibiotic, ceftobiprole with Johnson & Johnson in February 2005 was an important step to unlock the full potential of this product. The collaboration brings to Basilea a powerful, committed, global marketing partner with an established, successful franchise in anti-infectives. The development structure combines the expertise of both companies to bring ceftobiprole to the market. Our co-promotion option in major markets gives us important strategic flexibility regarding commercialization while the financial aspects of this collaboration reflect the “blockbuster” potential of ceftobiprole. Our effective partnership is evidenced by the initiation of the two planned phase III trials in hospital acquired pneumonia; the completion of enrolment into our first phase III trial in complicated skin infections; and the start of an additional phase III study designed to expand the potential usage of this drug in skin infections including the Gram-negative infections, which occur in diabetic foot ulcer patients.

In September 2005, we announced the positive results of our phase II trial for BAL8557 our novel broad-spectrum antifungal drug. The study clearly showed that BAL8557 is highly effective at curing patients of esophageal yeast infections. Different oral treatment schedules together with the availability of an injectable form give physicians extra flexibility and convenience to potentially optimize treatment of individual patients. The retention of global commercialization rights on BAL8557 has given us further strategic flexibility to optimize the value of this product as we advance it into phase III.

Basilea's international phase III trial of oral alitretinoin for patients with chronic, refractory hand dermatitis, a disabling condition for which there is currently no approved treatment, recruited well and we look forward to the first trial completion and results in 2006.

Basilea is one of the few remaining small companies specializing in anti-infectives, possessing both a late-stage clinical portfolio and a very substantial research asset base. We believe that innovation drives long-term value and sustainable growth by bringing new products into the development pipeline. Basilea's research progress in 2005 was reflected through numerous scientific publications and a novel antibiotic entering preclinical evaluation.

Our 2005 financial results show a sound cash position reflecting both the effective management of R&D expenses and the significant payments received from reaching milestones on our ceftobiprole collaboration. In reporting on the last 12 months, we would also like to thank our shareholders, our employees and our business partners in helping us to bring important new medicines to patients in need. We look forward to an exciting 2006 with the prospect of three compounds in phase III clinical development advancing toward the market.



Werner Henrich
Chairman of the Board



Dr. Anthony Man
Chief Executive Officer

Key Milestones

Basilea's major achievements in the last year were:

Ceftobiprole (BAL5788)

- Entering a very significant partnership with Johnson & Johnson for the development and commercialization of ceftobiprole with subsequent successful technology transfer and collaboration
- Initiation of ceftobiprole phase III pneumonia trials
- Completion of accrual on ceftobiprole's first phase III skin infection study
- Initiating a second ceftobiprole phase III skin study to broaden labeling including Gram-negative infections such as foot ulcer infections suffered by diabetic patients

BAL8557 – Antifungal

- Successful completion of BAL8557 phase II development including preparation of clinical supplies for phase III
- Retention of global commercialization rights to BAL8557

Alitreinoin (BAL4079)

- Recruitment of more than 75% of total planned patients into our alitreinoin phase III trial in Europe and Canada
- Completion of drug substance and drug product registration campaigns for alitreinoin including commercial product formulation

BAL19403 – Topical Macrolide Antibiotic

- Selection of BAL19403, our novel topical macrolide antibiotic, as a clinical candidate and completion of clinical supply for our proof of concept program

Ceftobiprole (BAL5788)

Bacterial resistance is an ever-increasing threat to healthcare. Whilst many pharmaceutical companies have ceased research on new antibiotics, Basilea continues to apply its expertise to discover and develop new medicines active against the growing healthcare threat of bacterial resistance and to bring these breakthrough antibiotics to the market. Ceftobiprole is the first of a novel generation of broad-spectrum cephalosporin antibiotics with excellent activity against resistant bacteria such as methicillin-resistant *Staphylococcus aureus* (MRSA), targeting hospital acquired infections caused by suspected or documented MRSA. Its unique extended spectrum of activity also includes Gram-negative pathogens. Ceftobiprole may therefore be well suited to replace a combination of antibiotics often required in the treatment of patients with, for example complicated skin infections or hospital-acquired pneumonia. Furthermore, extensive preclinical testing has shown that ceftobiprole's potential to induce resistance is low. Because ceftobiprole is a member of the penicillin family, it is expected to have a favorable safety profile, also confirmed by the observations in the clinic to date.

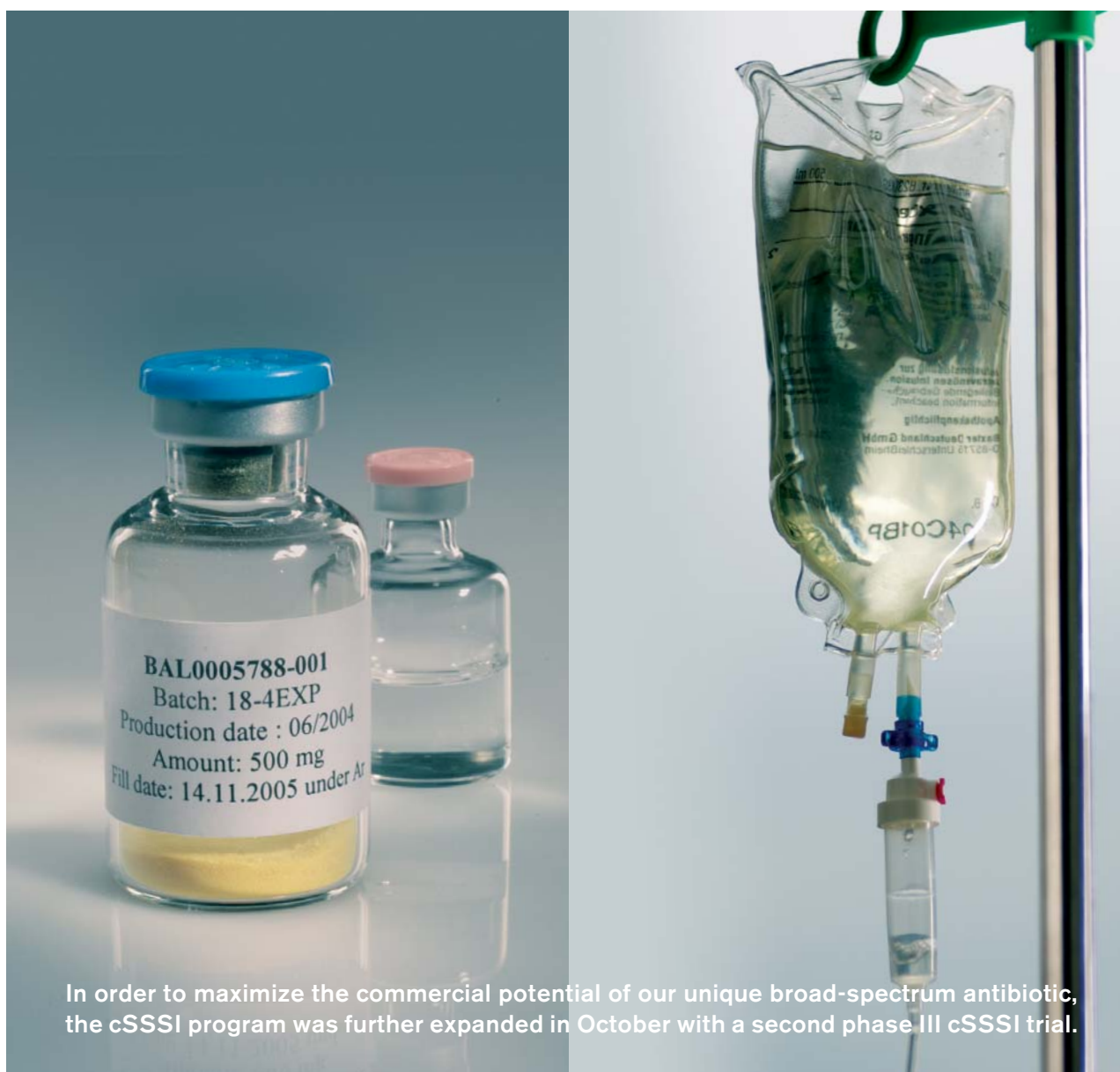
In February, the commercial potential of ceftobiprole was validated through a significant partnership with Johnson & Johnson for its development, manufacturing and commercialization. The agreement may provide Basilea with up to CHF 370 million in upfront and milestone payments, significant royalty payments upon commercialization and gives Basilea the option to co-promote the product in all major markets.

By mid 2005, the US IND for ceftobiprole as well as manufacturing were transferred to our partner Johnson & Johnson. A smooth transition of the drug supply chain was successfully accomplished without delays. Basilea continues to participate in the technical development of ceftobiprole with Johnson & Johnson. Through a joint steering committee, Basilea and Johnson & Johnson continue to deliver on the milestones of our substantial clinical development program. We continue to meet the regulatory requirements of our development program that has been awarded fast track designation, while optimizing the commercial potential of this key Basilea asset.

In April of this year, ceftobiprole, already in phase III testing for complicated skin and skin structure infections (cSSSI) also moved into international phase III trials in hospital-acquired pneumonia. Hospital-acquired pneumonia accounts for some 15% of all hospital infections. The mortality rate exceeds 30% and is highest among mechanically ventilated patients and patients infected with methicillin-resistant *Staphylococcus aureus* (MRSA).

In order to maximize the commercial potential of our unique broad-spectrum antibiotic, the cSSSI program was further expanded in October with a second phase III cSSSI trial targeting both Gram-positive and Gram-negative bacterial infections, including diabetic patients with foot infections. Diabetic foot infections are caused by bacterial *staphylococci* (including MRSA) and streptococci, and very often involve Gram-positive and Gram-negative bacteria. Adequate treatment of diabetic foot infections currently requires hospitalization, urgent surgery and combinations of intravenous antibiotics. In this phase III trial, ceftobiprole is compared against a combination of two antibiotics, which are currently necessary to provide the same potential broad-coverage we expect ceftobiprole alone to provide.

A positive outcome of these trials would confirm the unique spectrum of ceftobiprole such that ceftobiprole might replace a traditional combination treatment of two antibiotics. Data from the first cSSSI study expected in Q1 2006. Submission of the data to the health regulatory authorities in the USA and Europe is planned for 2007.



In order to maximize the commercial potential of our unique broad-spectrum antibiotic, the cSSSI program was further expanded in October with a second phase III cSSSI trial.



Alitretinoin (BAL4079)

Chronic hand dermatitis is frequently associated with occupational exposure to chemical or physical irritants or allergens. Alitretinoin is the first drug to be specifically developed for severe chronic hand dermatitis in patients who do not respond adequately to steroid creams. For these estimated one million patients there is currently no approved prescription treatment available.

The disease is not only socially disabling but also has significant impact on the daily activities and occupation of these patients. Severe chronic hand dermatitis is reported to lead to prolonged sick leave and to job loss in more than 20% of patients. As a potential new medical treatment, alitretinoin may provide pharmaco-economic benefits to the healthcare system by allowing workers disabled by this condition to get back to work.

The alitretinoin development program is expected to complete recruitment for its European/Canadian phase III registration trial in 2006. The application for market authorizations in Europe and Canada is planned for 2007. Technical development activities in 2005 focused on preparing data for regulatory submissions including registration campaigns of drug substance and drug product for alitretinoin. Manufacturing for launch and commercialization were initiated.

The regulatory climate in the USA for retinoids such as alitretinoin has remained challenging, as exemplified by the introduction of the iPLEDGE program requiring stringent tracking of systemic retinoid prescriptions and use. The design of the alitretinoin USA phase III clinical program has been discussed with the FDA under a Special Protocol Assessment to clarify all required measures so that patients and prescribers adequately manage pregnancy prevention and comply with newly introduced regulations in the USA.



BAL8557 – Antifungal

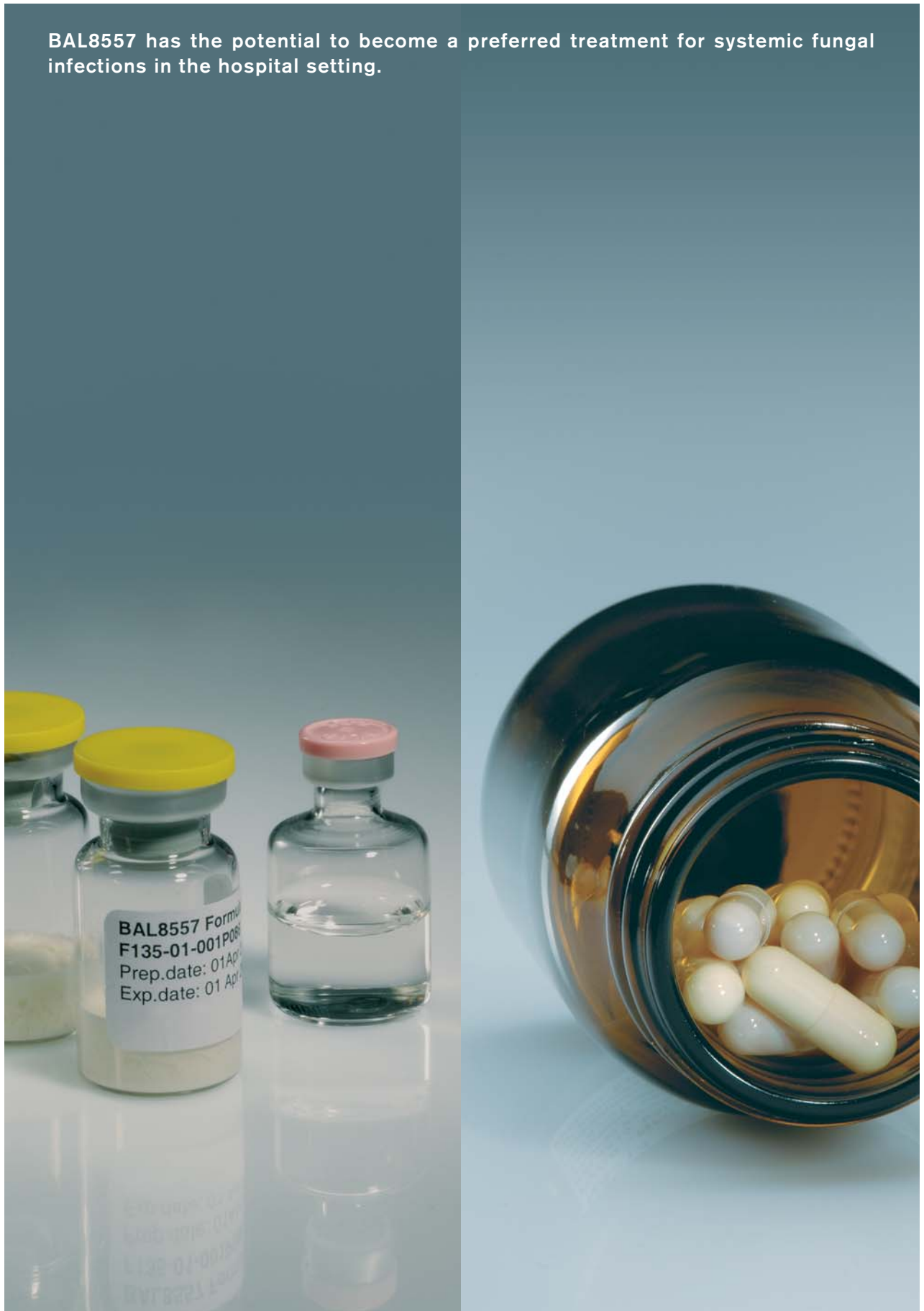
Basilea's antifungal, BAL8557 a water soluble azole, potentially addresses the growing medical need for a broad-spectrum, conveniently administered and well tolerated agent to fight fungal infections in the growing immuno-compromised patient population including cancer patients, transplantation patients and patients suffering from AIDS. The pattern of invasive fungal infections in immuno-compromised patients are rapidly changing with a decreasing incidence of candidiasis (particularly *Candida albicans*) but concomitant increases in yeast infections caused by non-*Candida albicans* species and infections caused by molds (*Aspergillus* species and others). Antifungal resistance is also becoming a concern for patients with extensive prior exposure to the current antifungal azoles.

BAL8557 has the potential to become a preferred treatment for systemic fungal infections in the hospital setting. It has a very broad-spectrum of activity covering most yeasts and molds causing serious infections in immuno-compromised patients including fluconazole-resistant *Candida* strains and difficult molds such as zygomycetes. With more than two million patients including confirmed infections and prophylactic treatment currently treated and an additional seven million at risk in the key markets of the USA and Europe the commercial potential of a broad-spectrum, well-tolerated antifungal is significant. Unlike the other azoles, BAL8557 is a prodrug suitable for simple intravenous administration and its excellent oral absorption allows a convenient once daily or even once weekly dosing.

Basilea completed its phase II trial showing good efficacy for all dose levels tested, and safety similar to that of fluconazole, the current gold standard treatment. The planned phase III trials will target severe invasive yeast (*Candida*) and mold infections including *Aspergillus* and zygomycetes. The preparations for the phase III program commenced in 4Q 2005. Preparations including the production of phase III drug substance of BAL8557 for the pivotal registration trial program are planned to start in 2006.

In December 2005, Roche determined that it would not exercise its option to license BAL8557. As a result, Basilea retained all commercialization and manufacturing rights to the compound with no royalties or other payments due to Roche. BAL8557 will be a complementary product to our antibiotic ceftobiprole for the hospital anti-infective market.

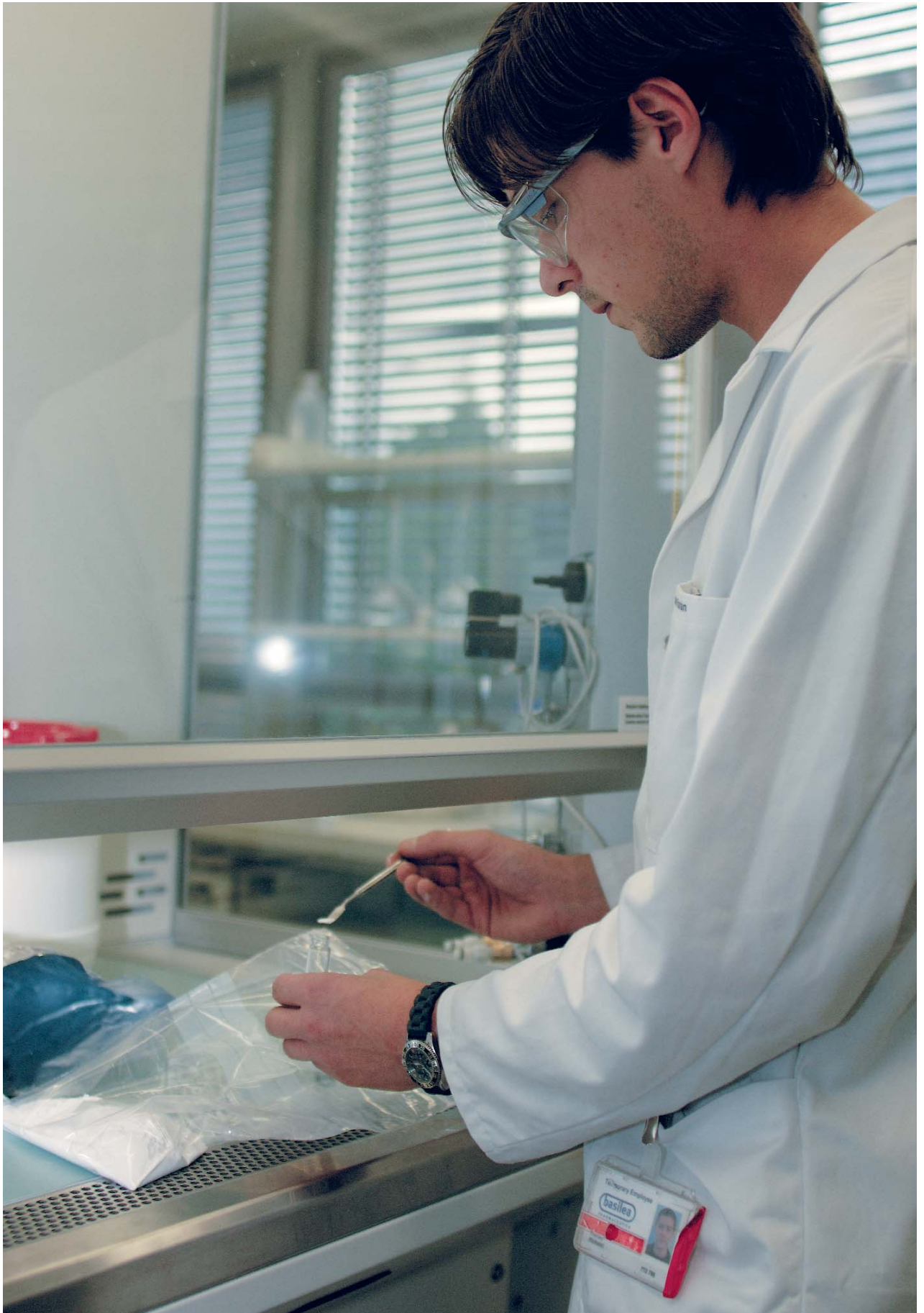
BAL8557 has the potential to become a preferred treatment for systemic fungal infections in the hospital setting.



BAL19403 – Topical Macrolide Antibiotic

BAL19403 is a macrolide antibiotic with potent in-vitro anti-inflammatory activity and high in-vitro efficacy against antibiotic-resistant *Propionibacterium acnes* the main pathogens of acne. Given the steady increase in antibiotic resistance among propionibacteria, BAL19403's unique dual action profile may provide an outstanding basis for a novel effective topical treatment option for inflammatory acne.

BAL19403 was selected as a clinical candidate at the beginning of 2005, initially in dermatology, for the treatment of mild to moderate inflammatory acne and rosacea and completed preclinical evaluation. Good Manufacturing Practice (GMP) drug supply was successfully prepared through the development of a chemical process based on our established research synthesis methods to advance the candidate compound through preclinical evaluation and early clinical testing. Formulation development for a topical application was also initiated during 2005. A first feasibility study in humans is in preparation for the first part of 2006.



Research Portfolio

In addition to providing support to existing development compounds, our continuous product-oriented research resulted in a number of achievements in 2005. BAL19403, a novel topical antibiotic from Basilea Research successfully concluded preclinical evaluation as a potential therapy for mild to moderate inflammatory acne; further promising molecules from our later stage Gram-negative antibiotics program were advanced for preclinical assessment; and from our Gram-positive resistance program, a novel compound series was advanced to the lead optimization stage. Finally, substantial progress was made with a number of earlier projects.

Focus on Bacterial Resistance

Bacteria's ability to develop resistance toward antibiotics became evident during the clinical testing of the earliest antibiotics. The clinical usage of each new antibiotic has been followed by the appearance of bacterial strains that have newly become antibiotic resistant. Such resistant strains can pose a severe threat in hospitals. For example, *Staphylococcus aureus* was difficult to treat before the introduction of penicillin in 1941. In 1953, penicillin-resistant *Staphylococcus aureus* erupted as a global epidemic that caused many deaths and closure of hospital wards around the world. This organism was eventually overcome by the introduction of methicillin in 1961 but, during the early 1990s, methicillin-resistant *Staphylococcus aureus* became well established in hospitals in many countries with, for example, more than 50% of hospital isolates in the USA being resistant. The genes that are responsible for the resistance were transferred to strains that occur in the general public. For some years vancomycin was one of the few antibiotics that could be relied upon to treat infections caused by methicillin-resistant *Staphylococcus aureus*, but now the first strains that are resistant to this antibiotic too have started to appear in hospitals. Basilea's ceftobiprole, already in phase III clinical development, represents the next generation of antibiotics that is able to rapidly kill and clear these organisms from infected patients.

There are now many bacteria besides *Staphylococcus aureus* where the incidence of resistance has reached worrying levels that severely limit the therapeutic options available for treatment. The most recent developments are the appearance of strains of Gram-negative bacteria such as *Pseudomonas*, *Acinetobacter* and *Klebsiella* that are resistant to many, if not all, available antibiotics. The appearance of these "pan-resistant" strains of organisms such as *Pseudomonas aeruginosa*, which are associated with rapid onset of morbidity and high mortality, is regarded with great concern by many clinicians. Basilea's antibacterial programs described below address this serious problem of resistant bacteria.

Antibiotics Targeting Gram-Negative Bacteria

The formidable resistance of the Gram-negative bacteria occurs through a combination of factors including, the protective properties of the outer bacterial cell membranes, drug efflux pumps, enzymes that destroy the antibiotics, and mutation of a target so that the bacteria becomes immune to the effects of an antibiotic. Basilea has identified potent lead molecules that overcome many of these obstacles and thus quickly reach the right bacterial target. Testing against a wide variety of multi-drug resistant Gram-negative pathogens has shown that these new leads have a broad spectrum of action against recent clinical isolates, including pan-resistant strains.

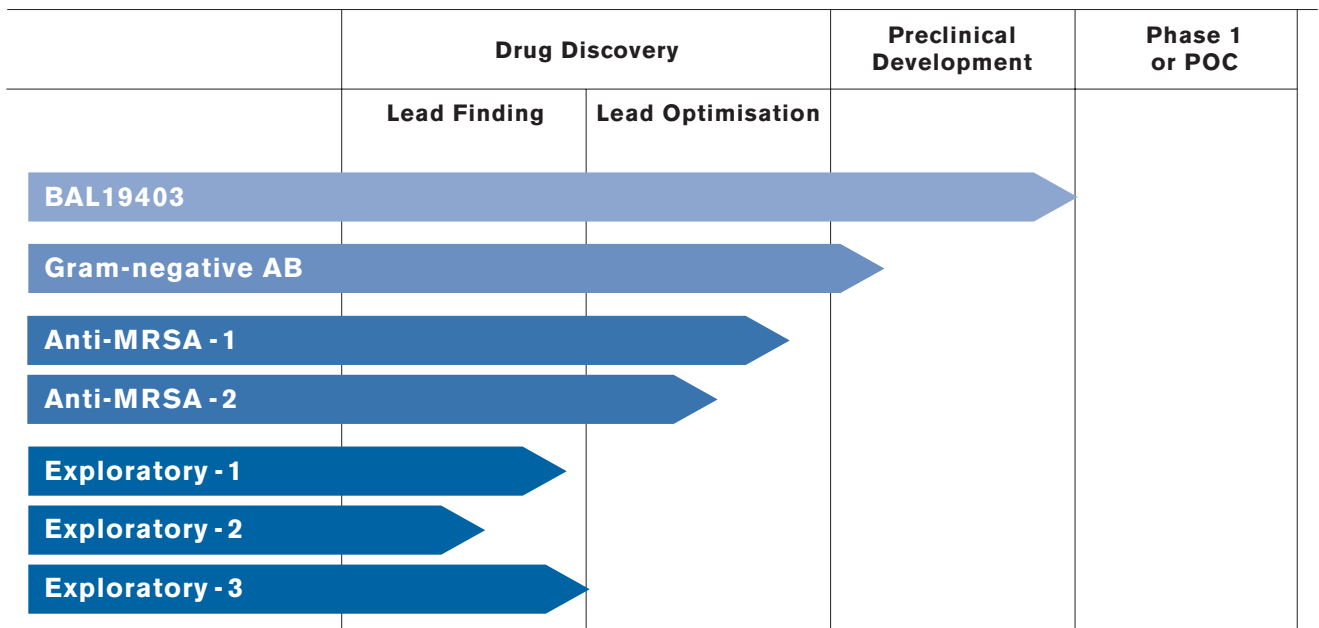
Antibiotics Targeting Methicillin-Resistant *Staphylococcus Aureus* (MRSA)

The development of resistance in major pathogenic Gram-positive bacteria has led to the need for new agents that are able to overcome existing resistance mechanisms. Of particular concern is the widespread methicillin-resistance of staphylococci in hospitals and increasingly also in the community (e.g. “super bugs”). There are few, new, orally available agents with a favorable side effect profile that are active against multi-resistant bacterial species. The development of such an agent would complement to intravenous ceftobiprole and offer an attractive therapy option for ambulant patients diagnosed with community-acquired MRSA. Utilizing our detailed knowledge and the long-standing experience with anti-MRSA antibiotics, Basilea is working towards orally bioavailable antibiotics with activity against methicillin-resistant *staphylococci*.

Broad-Spectrum Antibiotics

Prompt initiation of antibiotic therapy is essential to reduce mortality among critically ill patients. In cases where the pathogens have yet not been identified, empiric broad-spectrum antibiotic treatment is usually administered to cover both Gram-negative as well as Gram-positive bacteria. However, outcomes are increasingly compromised by emergence of antibiotic resistance among pathogens. Given the widespread occurrence of antibiotic resistance towards many existing antibiotics, new broad-spectrum antibacterial agents able to overcome existing resistance mechanisms are needed. Basilea, using its proprietary technology platforms and the extensive experience in infectious diseases research, is building upon its track record with ceftobiprole and is actively engaged in the discovery of novel, safe and potent broad-spectrum antibiotics.

Focus on Bacterial Resistance



AB Antibiotic
Anti-MRSA Antibiotic against methicillin-resistant *Staphylococcus aureus* bacteria
Exploratory Early project validating new targets
POC Proof-of-Concept

Narrower-Spectrum Antibiotics

In some clinical circumstances, antibiotics need specific activities to be successful. Many different opportunities exist for “customized” drugs including serious eye infections, chronic pulmonary infections and diabetic foot infections. Basilea is exploiting its broad asset base to identify molecules that could be used in these specialized, challenging and significant disease areas.



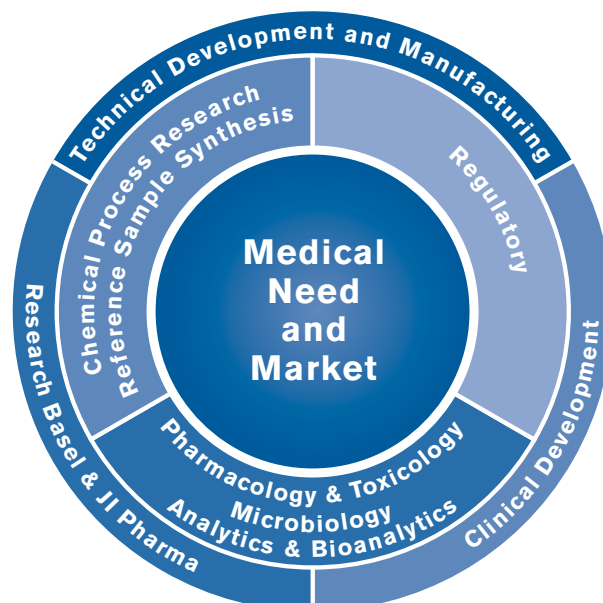
An Integrated R&D Organisation

Basilea has a unique integrated structure that includes all the necessary expertise and technology in-house to innovate and develop new medicines through the completion of clinical development prior to launch. A core R&D philosophy at Basilea is to efficiently move forward projects in our pipeline by sharing experience and resources in all areas from late research to early development.

The concept of integrating all functions allows us to develop the right market profile for a new medicine and to guide the selection of the best drug candidate at a very early stage. Furthermore, it ensures the appropriate early initiation of all critical activities necessary for chemical and pharmaceutical development including manufacturing of supply for the first toxicology and clinical studies.

Development

To minimize fixed costs and retain resource flexibility, Basilea continues to outsource many of its development activities with a highly experienced team of managers who keep oversight and overall coordination in-house. With our in-house toxicology and pharmacology expertise, Basilea guides the discovery process and the development of our compounds without the delays that often come when a compound transitions from research to development. Basilea's physicians and scientific staff continually communicate with the international medical community to be at the forefront of understanding patients' medical needs. A continuous dialogue with health authorities in USA and Europe results in development programs targeted to achieve competitive labeling.



Technical Development and Manufacturing

The Technical Operations group was strengthened by the formation of a Quality Unit (Quality Assurance/Quality Control; "QA/QC") to further enforce our commitment to quality management. The group takes an integrated technical development and quality management approach from early project phases to launch. All required experts in chemistry, pharmaceuticals, analytical development, QA and QC are represented in our teams and therefore allow qualified and rapid decision making.

Basilea's central Analytics Group is equipped with state-of-the-art technology and expertise that has proven, through our consistent achievement of development milestones, to provide a continual transfer of analytical know-how between different disciplines, projects and external partners. Maintaining and improving the analytical knowledge on all of Basilea's compounds is a key success factor for rapid, high quality R & D. Analytics provides support to research groups, performs all in-house bioanalytics for preclinical studies, out sources clinical study and toxicology samples for external analysis and provides the necessary analytical development activities for all projects.

Research

Basilea Research has all the required technologies and skills to efficiently carry out drug discovery programs from target identification, lead finding, lead optimization to final clinical candidate selection in antibiotics. Core strengths are in biochemistry, microbiology, cell biology, medicinal chemistry and discovery informatics. Special emphasis is put on state-of-the-art electronic data capture and shared chemistry/biology databases. JI Pharma, our wholly owned research center in Haimen, People's Republic of China, is an integral part of the discovery effort, providing a significant portion of the chemistry resources, including process research to prepare chemical syntheses for transition into technical development.

Leverage of R&D Activities by Basilea's Chinese Research Center, JI Pharma

In 2005, Basilea's fully owned Chinese research subsidiary, JI Pharma Ltd., was awarded the prestigious Chinese High-Tech Status by the Chinese government in recognition of its operational excellence. In addition, the local management team was strengthened by the recruitment of a seasoned pharmaceutical executive, Professor Jeffrey Shen, as the general manager.

The center further increased its activities supporting both research discovery projects and clinical development product needs. As part of our collaboration with Johnson & Johnson, a unit of chemists dedicated specifically to supporting ceftobiprole development and registration needs was established. In addition, reference compounds were also synthesized for the two clinical development projects BAL8557 and alitretinoin (BAL4079). This past year, well over 7'000 complex and difficult chemical reactions were performed. These efforts have substantially contributed to advancing another potential candidate into pre-clinical assessments.

The analytical department was further strengthened to ensure the identity and the required purity of all compounds. Chemical process research at the center focused on establishing a proprietary and cost effective synthesis of an important building block for our late-stage antifungal compound BAL8557.







Corporate Governance

Group Structure and Shareholders

Group Structure

The Basilea group is composed of its parent company Basilea Pharmaceutica Ltd. ("Basilea"), BPh Investitionen Ltd. ("BPh"), a subholding company, and Jiangsu Innovative New Drug Research Center Co. Ltd. ("JI Pharma"), a Chinese operating subsidiary held through BPh (collectively the "Company").

The operating activities of the Company are focused on research and development of pharmaceutical products. Currently, there are no sales or marketing activities in the Company. The Company's operating activities are directed by and primarily located within Basilea, with supporting activities carried out by JI Pharma, as further described.

Basilea is operationally organized along its core activities with a development function, headed by the Chief Development Officer, and a research function, headed by the Chief Scientific Officer. Both heads are members of the Management Committee, together with the Chief Financial Officer, who is responsible for Finance and Business Development. The Management Committee is led by the Chief Executive Officer.

Basilea controls BPh and JI Pharma through representatives on the respective board of directors. In addition, there is a close cooperation related to the day-to-day operations between Basilea's research and supply groups and JI Pharma.

Basilea Pharmaceutica Ltd.

Basilea is located at Grenzacherstrasse 487, 4058 Basel, Switzerland, and Basilea's shares were listed on the SWX Swiss Exchange on March 25, 2004, under the Swiss security number (Valorenummer) 1 143 244. The ISIN is CH 001 143 244 7. The Common Code is 018859220. The ticker symbol is BSLN. As of December 31, 2005, the market capitalization of Basilea amounted to CHF 1,033,673,778 (7,436,502 registered shares at CHF 139.00 per share). None of its shares are held by the Company. As of December 31, 2005, Basilea engaged approximately 116 employees (full-time equivalents).

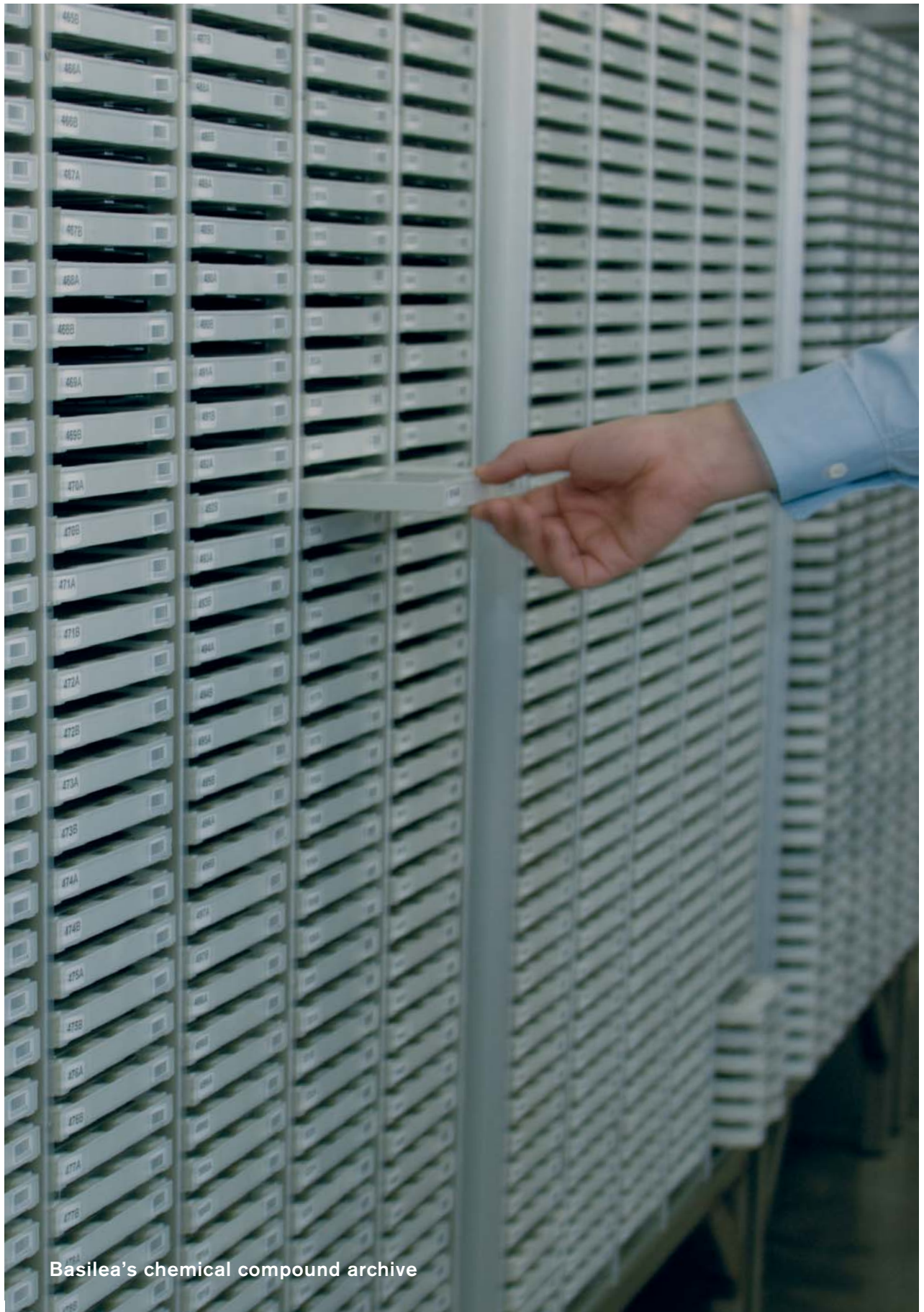
BPh Investitionen Ltd.

BPh is a Swiss stock corporation with registered office at Zugerstrasse 76b in 6340 Baar, Switzerland. BPh has a share capital of CHF 130,000, divided into 10,000 fully paid-up registered shares with a par value of CHF 13 each, all held and controlled by Basilea. The shares of BPh are not listed on any stock exchange. BPh is a subholding company holding a 100% interest in JI Pharma.

Jiangsu Innovative New Drug Research Center Co. Ltd.

JI Pharma is a stock corporation, founded May 29, 2002, and incorporated with limited liability under the laws of The People's Republic of China, with a fully paid up share capital of USD 7.0 million as of December 31, 2005. All of its issued shares are held and controlled by BPh. It is located in the Haimen Municipal Economic Zone, Jiangsu Province (north of Shanghai), People's Republic of China. JI Pharma is engaged in providing complementary services, primarily in the field of chemical synthesis research and development, in connection with Basilea's research and development compounds. The shares of JI Pharma are not listed on any stock exchange.

As of December 31, 2005, JI Pharma engaged approximately 82 employees (full-time equivalents).



Basilea's chemical compound archive

Capital Structure and Shares

Significant Shareholders

To the best of our information, the shareholders shown on the following table held 5% or more of the shares and voting rights of Basilea as of December 31, 2005.

Before its IPO of March 25, 2004, Basilea was informed that all shareholders of Basilea existing prior to the IPO entered into a shareholders' agreement originally dated October 27, 2000. The Company is not a party to that agreement and is not informed as to whether such agreement is still in force or has been amended post-IPO. It can therefore give no assurance as to its continued effectiveness and validity. To the knowledge of Basilea, this shareholders' agreement expired in March 2005.

Basilea received a notification of shareholdings pursuant to article 20 of the Swiss Federal Act on Stock Exchanges and Securities Trading (SESTA) on September 23, 2005 from March Limited, 3 Queen Street, Hamilton HM 11, Bermuda (Beneficial owner Ms. Traudl Engelhorn-Vechiatto, c/o March Limited), indicating that March Limited has reduced its shareholdings in Basilea and, as a result, holds less than 5% in Basilea's shares. The notification was published in the Swiss Official Gazette of Commerce ("Schweizerisches Handelsamtblatt") on September 30, 2005.

Shareholder	Number of registered shares	Ownership percentage
F. Hoffmann-La Roche Ltd. Grenzacherstrasse 124 4070 Basel, Switzerland	2 450 000	32.95%
HBM BioVentures (Cayman) Ltd. 10 Eucalyptus Building, Crewe Road George Town, Grand Cayman Cayman Islands, British West Indies	627 483	8.44%
Chase Nominees Ltd. London, United Kingdom (According to the share register, Chase Nominees Ltd. does not hold these shares in its own name)	403 491	5.43%
Venturetec Inc. Pasea Estate, Road Town Tortola, British Virgin Islands	402 930	5.42%
Varuma AG Aeschenvorstadt 55 4051 Basel, Switzerland	395 000	5.31%

The numbers of shares and ownership percentages in the table above reflect the situation as per December 31, 2005, taking into account changes in share capital caused by the exercise of options during 2005 and the indications on significant shareholdings reflected in note 8 to the Financial Statements pursuant to article 663c CO.

Cross-Shareholdings

No cross-shareholdings existed as of December 31, 2005.

Share Capital

The share capital of Basilea as of December 31, 2005, amounted to CHF 7,436,502, consisting of 7,436,502 registered shares with a par value of CHF 1 per share. The share capital is fully paid up. As of December 31, 2005, the Company did not hold any shares of Basilea.

Authorized Capital and Conditional Capital

As of December 31, 2005, total authorized capital amounts to CHF 540,000 and total conditional capital amounts to CHF 2,583,639.

On November 21, 2003, an extraordinary shareholders' meeting approved the creation of an authorized capital of CHF 2,640,000, under which the Board of Directors was authorized to issue up to 2,640,000 registered shares with par value of CHF 1 each, to be fully paid up, in one or several steps. The share capital of Basilea was increased by an amount of CHF 2,100,000 through the issuance of 2,100,000 registered shares with a par value of CHF 1 each on March 23, 2004, in connection with Basilea's IPO. The shares issued in this capital increase stemmed from the authorized capital. This capital increase was entered into the Commercial Register of Basel-Stadt on March 24, 2004. On April 12, 2005, the ordinary shareholders' meeting approved authorized capital in the amount of CHF 540,000, valid until April 12, 2007, which was entered into the Commercial Register of Basel-Stadt on April 14, 2005. The timing as well as the terms and conditions of the issuance of new shares under this authorized capital are to be set by the Board of Directors. The Board of Directors is entitled to exclude the preferential subscription right ("Bezugsrecht") of shareholders if the capital increase is made for the purpose of granting an interest to strategic partners, or for the acquisition of business undertakings, a participation in business undertakings, participations, products or license rights for the development, manufacturing or distribution of products in the area of pharmaceuticals, biology or diagnostics. Unused preferential subscription rights are at the disposal of the Board of Directors, who may place them at market conditions.

Furthermore, shareholders approved conditional capital of up to CHF 2,640,000 (2,640,000 registered shares with a par value of CHF 1 each, to be fully paid up,) in the extraordinary shareholders' meeting of November 21, 2003. CHF 2,000,000 of the conditional capital are reserved for the exercise of option rights granted under the Company's stock option plan at a strike price to be set by the Board of Directors, and CHF 640,000 are reserved for the exercise of option or conversion rights granted to the holders of options or bonds in connection with new bonds or similar debt instruments that would be issued by Basilea or one of its subsidiaries, and for which the Board of Directors is entitled to set the conditions. The preferential subscription rights of shareholders are excluded under the conditional capital. The prior subscription right of shareholders ("Vorwegzeichnungsrecht") is granted for the portion of CHF 640,000, but its exercise is limited to three working days. The minimum issue price for shares issued in connection with bonds or similar debt instruments has to amount to at least CHF 75 per share. Relating to bonds or similar debt instruments connected with conversion or option rights for which the prior subscription right is withdrawn, the option rights may be exercised only during a maximum period of seven years, and the conversion rights only during a maximum of ten years.

In 2005, 55,548 and, in 2004, 813 registered shares with a par value of CHF 1 per share were issued under the conditional capital in connection with the exercise of stock options under Basilea's stock option plan.

Any shares issued under the authorized or conditional capital are subject to the transfer restrictions set forth under "Limitations on Transferability of Shares and Nominee Registrations" (see below).

Changes in Capital

In 2005, 55,548 registered shares have been issued as a result of the exercise of stock options under Basilea's stock option plan.

In 2004, Basilea increased its share capital by CHF 2,100,000 (2,100,000 registered shares with a par value of CHF 1 per share) in connection with its IPO. In addition, 813 registered shares were issued as a result of the exercise of stock options under Basilea's stock option plan.

Before, Basilea increased its share capital by CHF 2,801,410 (280,141 registered shares with a par value of CHF 10 per share) in June 2003, through a private round of financing. It thereby increased its share capital from CHF 50,000,000 to CHF 52,801,410. The share capital was later reduced to CHF 5,280,141 pursuant to a resolution of the extraordinary shareholders' meeting of November 21, 2003, by a reduction of the par value of the shares from CHF 10 to CHF 1. The nominal reduction amount was not returned to the shareholders but was booked as a free special reserve of Basilea.

For further information on changes in capital in 2005, 2004 and 2003, including changes in reserves and retained earnings, please refer to the Consolidated Statement of changes in Shareholders' Equity as well as note 12 (Shareholders' Equity) to the Consolidated Financial Statements and note 6 (Share Capital, Authorized Capital and Conditional Capital) to the Financial Statements of Basilea. Please also refer to the consolidated statement of changes in shareholders' equity included in the Annual Reports 2004 and 2003 for information on changes in equity in 2004 and 2003.

Shares

Basilea has only one class of shares (registered shares) and the par value of Basilea's shares is CHF 1 per share. Each share is fully paid up and carries one vote and equal dividend rights, with no special privileges.

Participation and Profit Sharing Certificates

Basilea has not issued any participation or profit sharing certificates.

Limitations on Transferability of Shares and Nominee Registrations

Basilea's shares are not certificated since its IPO. Shareholders are not entitled to request printing and delivery of share certificates, but Basilea may, in its sole discretion, decide to print and deliver share certificates. Any shareholder may, however, at any time request Basilea to issue a confirmation regarding its shareholding, but such confirmation is not a negotiable instrument.

The transfer of shares occurs through an entry in the books of a bank or depository institution following an assignment in writing by the selling shareholder and notification of such assignment to Basilea by the bank or the depository in-

stitution. A transfer of shares further requires that a shareholder files a share registration form in order to be registered in the share register of Basilea with voting rights. Failing such registration by the deadline set from time to time by the Board of Directors, a shareholder or usufructuary ("Nutzniesser") may not vote at or participate in a shareholders' meeting but is still entitled to receive dividends and other rights of financial value. No exemptions were granted from the above restrictions in 2005.

According to article 5 of Basilea's Articles, a purchaser of shares will be recorded in Basilea's share register as a shareholder or usufructuary with voting rights if the purchaser discloses its name, citizenship or registered office, respectively, and address and gives a declaration that it has acquired the shares in its own name and for its own account. According to the nominee regulation enacted by the Board of Directors, a person or legal entity not explicitly stating in its registration request that it will hold the shares for its own account ("nominee") may be entered as a shareholder in the share register with voting rights for shares up to a maximum of 3% of the outstanding nominal share capital, provided such nominee enters into a nominee agreement with Basilea. Shares held by a nominee that exceed this limit are only registered in the share register with voting rights if such nominee declares in writing to disclose name, address and shareholding of any person or legal entity for whose account he is holding 0.5% or more of the outstanding nominal share capital. The limit of 3% shall apply correspondingly to nominees who are related to one another through capital ownership or voting rights or have a common management or are otherwise interrelated.

Basilea's Articles do not further limit the transferability of shares. A qualified majority of at least two-thirds of the share votes represented as well as the majority of the par values of shares represented at a shareholders' meeting are required for resolutions on transfer restrictions of Basilea's shares. For further information on the registration in the share register, please refer to the section "Registration in the Share Register" on page 49.

Shares may only be pledged by written pledging agreement to the bank that administers the book entries of such shares for the account of the pledging shareholder. Basilea needs not to be notified of such pledging.

Convertible Bonds and Options

For information on the stock option plan for directors, management and employees, and on the number of options granted thereunder, please refer to note 11 "Stock-Based Compensation" of the Consolidated Financial Statements included in this Annual Report. For information regarding options granted to members of the Board of Directors and of the Management Committee, please refer to section "Compensation, Shareholdings and Loans" on page 44.

As of December 31, 2005, the Company did not have any convertible bonds outstanding.



Left to right (standing): Prof. Daniel Lew | Dr. Gottlieb Keller | Dr. Walter Fuhrer | Prof. Peter van Brummelen | Dr. Andreas Wicki
Left to right (sitting): Mr. Ronald Scott | Mr. Peter Friedli | Mr. Werner Henrich | Dr. Anthony Man

Board of Directors

Members, Functions and Other Activities

The following table sets forth the name and terms of the current members of the Board of Directors:

Name	Year of first election	End of current election period
Werner Henrich, Chairman	2000	2007
Dr. Andreas Wicki, Vice-Chairman	2000	2007
Peter Friedli	2000	2007
Dr. Gottlieb Keller	2003	2006
Prof. Peter van Brummelen	2003	2006
Dr. Walter Fuhrer	2003	2006
Prof. Daniel Lew	2003	2006
Dr. Anthony Man	2004	2008
Ronald Scott	2004	2008

A description of each member's nationality, business experience, education and activities is outlined below:

Werner Henrich, Chairman, was born 1943 and is a French citizen. He has an education as a chemist and European patent attorney. He worked for F. Hoffmann-La Roche Ltd. ("Roche") in Basel for more than 30 years. Mr. Henrich held various positions at Roche including Head of Global Intellectual Property and Pharmaceutical Licensing for more than 12 years. He was also a member of the Roche Pharmaceutical Division Executive Board. In this function Mr. Henrich was responsible for intellectual property activities of all Roche divisions and for major pharmaceutical transactions including research collaborations, patent settlements, licensing-in and -out as well as product acquisitions. From February 2001 to October 2001, Mr. Henrich acted as CEO of Basilea. He retired from Roche in November 2003. Mr. Henrich has a wide experience in the pharmaceutical industry both with start-ups and large pharmaceutical compa-

nies. Mr. Henrich is also a member of the board of directors of Actelion Ltd., a Swiss biopharmaceutical company listed on the SWX Swiss Exchange, and acts as a consultant for several biopharmaceutical companies on a part-time basis.

Andreas Wicki, Vice-Chairman, was born in 1958 and is a Swiss citizen. He holds a Master of Science and a Ph.D. in chemistry and biochemistry from the University of Berne. Dr. Wicki is a successful healthcare entrepreneur and investor in the pharmaceutical and biotechnology industries. He was CEO of Clinserve AG and ANAWA Holding AG, two European Clinical Research Organisations. Dr. Wicki currently serves as CEO of HBM Partners AG, the investment advisor of the life science investment company HBM BioVentures AG. He is also a board member of HBM BioVentures (Cayman) Ltd. Furthermore, Dr. Wicki is on the board of directors of Buchler GmbH, MDS Pharma Services Switzerland AG and HBM Partners AG.

Peter van Brummelen was born in 1943 and is a Dutch citizen. He has an M.D. and a Ph.D. from the University of Leiden (The Netherlands). After military service and training in internal medicine he worked in the University Hospital of Leiden in various staff positions in internal medicine and nephrology. In 1979 he did a fellowship in Cardiology at the University Hospital in Basel. His main research interest was in cardiovascular disease and clinical pharmacology. He has (co-)authored more than 200 publications and book chapters. In 1986, he was appointed professor of medicine at the University of Leiden. He joined Roche in 1988 where he became Therapeutic Area Head Cardiovascular Diseases and worldwide Head of Clinical Pharmacology. In these functions he contributed to the successful development of various new drugs in different therapeutic classes. In 1990, he was appointed professor of medicine at the University of Basel. He was also actively involved in several projects to rationalize drug development and he was a founder of the European Course in Pharmaceutical Medicine (ECPM), where he is still a Member of the Steering Committee. Since 1996 he has acted as Vice President Clinical Operations at Solvay Pharmaceuticals and later as Executive Vice-President Research and Development of Yamanouchi Europe until his retirement in May 2003. Prof. van Brummelen is on the board of Biozell S.p.A., Milan, Diatos S.A., Paris, and IQ Corporation BV, The Netherlands. Prof. van Brummelen is currently an independent consultant to the pharmaceutical industry.

Peter Friedli was born in 1954 and is a Swiss citizen. He has been a principal of the investment banking firm Friedli Corporate Finance, Inc., a Swiss venture capital firm, since 1986. Mr. Friedli has over 20 years of entrepreneurial experience as an independent investment manager in venture capital and has specialized in high-tech investments predominantly domiciled in the United States in the areas of biotechnology, communications, technology and internet. He has held interests in more than 165 venture companies ranging from start-up to pre-IPO stage. Mr. Friedli possesses an active involvement in the management of a number of those companies and also serves on a number of boards of directors of private and public companies. He is chairman and investment manager of New Venturetec Ltd., a Swiss publicly traded venture investment company. Prior thereto, he worked in the field of international management consulting for service and industrial companies in Europe and the United States. Mr. Friedli is among others on the board of directors of the biotechnology companies Osiris Therapeutics Inc. and Prolexys Pharmaceu-

ticals. For further information on board memberships in public companies, please refer to section "Cross-Involvement of Board Memberships" below.

Walter Fuhrer was born in 1940 and is a Swiss citizen. He is an independent senior consultant in drug discovery with more than 25 years broad experience in conducting and managing medicinal chemistry and drug discovery. After completing a Ph.D. in organic chemistry at the Eidgenössische Technische Hochschule ETH in Zürich in 1973, he joined Ciba-Geigy AG (later Novartis) where he held different positions in medicinal chemistry and in research management both in Switzerland and in the United States. As Head of Cardiovascular Chemistry he was heavily involved in the discovery and development of Diovan®, a new blockbuster antihypertensive drug. After heading the Central Research Laboratories of Ciba-Geigy AG for five years (until the merger with Sandoz) he then served as Head of Operations and Planning in Novartis' Oncology Research until 2001. Dr. Fuhrer has served as reviewer on "The Journal of Medicinal Chemistry" and is presently a member of the editorial board of "Current Opinions in Drug Discovery and Development".

Gottlieb Keller was born in 1954 and is a Swiss citizen. He studied law and economics and received his Doctor of Law degree from the University Basel in 1980. He subsequently received his admission as attorney-at-law (1981) and as notary public in Basel (1984, not practising). He started his professional career in 1984 at the Roche's Corporate Law Department. In 1989, Dr. Keller was named Head of Business Development and Pharma Marketing Services of Hoffmann-La Roche AG, Grenzach Whylen, Germany. In 1992, he was promoted to Assistant to the Chairman of the Board of Directors of Roche Holding Ltd. In 1996, he became Head of Human Resources at Hoffmann-La Roche AG, Grenzach Whylen, and Chairman of the Executive Board of Roche Deutschland Holding GmbH, and was appointed Secretary to the Board of Directors of Roche Holding Ltd. and Corporate Compliance Officer of the Roche Group in 1999. In 2003, he was named Member of the Corporate Executive Committee of the Roche Group and Head of Corporate Services and Human Resources of Roche. Dr. Keller is President of the Board of Crocodil AG and member of the Board of the International School of the Basel Region AG as well as Acting Committee Member of the VSUD (Verband Schweizerischer Unternehmen in Deutschland) and of the Chamber of Commerce Germany -Switzerland. In addition, Dr. Keller is a member of the Fritz Gerber Foundation for talented young people and member of the Board of Trustees of the Paul Sacher Foundation.

Daniel Lew was born in 1948 and is a Swiss citizen. He is a Professor of Medicine at the University of Geneva Medical School and Chief of the Service of Infectious Diseases, Department of Internal Medicine at the Geneva University Hospitals. He obtained his MD degree from Geneva University in 1976 and specialized in infectious diseases both in Geneva and then subsequently at Harvard Medical School and Massachusetts General Hospital in Boston, Massachusetts, United States. He is a recipient of numerous scientific awards and grants for his research work. Professor Lew lectures widely, acts both as reviewer and editor for several major scientific journals and is author of many publications on neutrophil function, bacterial pathogenesis and drug resistance.

Anthony Man, Chief Executive Officer, M.D., FRCP, was born in 1956 and is a Swiss citizen and holds an honours degree in biochemistry in addition to a

medical degree. In addition, he is an elected Fellow of the Royal College of Physicians (UK) by distinction ("FRCP"). Dr. Man has over 19 years pharmaceutical industry experience in the United Kingdom, France and Switzerland. He has been involved in numerous successful product developments in different therapeutic areas, particularly oncology. He has held a variety of senior managerial and operational positions spanning from pre-clinical development to registration and commercialization while at Lederle, Roche, Ciba-Geigy and Novartis. As Chief Development Officer at Basilea from 2001 to 2003, he built up the drug development organization and advanced all key development products through their major milestones. In April 2003, Dr. Man was appointed as Chief Executive Officer. As a faculty member, he has taught regularly on the European Course of Pharmaceutical Medicine (ECPM). He is a member of the scientific advisory board of Lymphosign Inc., a privately held Canadian biotechnology company.

Ronald Scott, Chief Financial Officer, was born in 1955 and is a Swiss citizen. Mr. Scott obtained undergraduate and graduate degrees in planning with emphasis in finance. Prior to joining Basilea, he worked for nine years at Roche in management positions in Pharmaceutical Finance, Licensing and the Roche Corporate Finance Mergers and Acquisitions group. His assignments included managing Roche's call, primary and secondary offerings on Genentech; Roche's biotechnology investment portfolio; acquisitions and divestitures. Prior to joining Roche, Mr. Scott worked for Prudential Investment Corporation in the United States as director in Prudential's Finance and International Business Development Units, managing divestitures and joint venture transactions.

Dr. Man, CEO of Basilea, and Mr. Scott, CFO of Basilea, are Executive Members of the Board of Directors. Neither Dr. Man nor Mr. Scott are members of any of the Board Committees. All other members were non-executive board members in 2005.

Mr. Henrich, Chairman of the Board, acted as CEO of Basilea from February 2001 to October 2001. None of the other non-executive members of the Board of Directors have served in the management of Basilea or any of its subsidiaries since inception of Basilea. In addition, Mr. Henrich acted as a Consultant to Basilea in 2005.

There is a contractual relationship existing between Basilea and Roche, represented by Dr. Keller. Basilea has an agreement with Roche with respect to certain of its research molecules, that allows Roche to opt-in on such compounds in exchange for milestone payments and potential future royalties. Basilea is currently not pursuing those research molecules for which Roche has opt-in rights.

There are no other significant business connections between non-executive members of the Board of Directors and Basilea or any of its subsidiaries. For further information, please refer to note 15 (Related Party Transactions) of the Consolidated Financial Statements.

Cross-Involvement of Board Members

The Board memberships of Basilea's Board Members in other listed companies are included below:

Mr. Henrich holds a board membership in Actelion Ltd., Allschwil, Switzerland.

Mr. Friedli is a board member in the following public companies: New Venturetec Ltd., Zurich, Switzerland, and E-centives, Inc., Bethesda, USA.

Elections and Terms of Office

Basilea's Articles provide for a Board of Directors consisting of between one and eleven members. Members of the Board of Directors are appointed and removed exclusively by shareholders' resolution. Their term of office is three years, re-election being allowed. According to the Articles, elections are made by rotation in such a way that the term of office of about one third of the members of the Board of Directors expires every year. The Chairman and the Vice-Chairman of the Board of Directors are designated by the Board of Directors.

According to the current organizational regulations of Basilea ("Organizational Regulations") enacted by the Board of Directors, each member of the Board of Directors shall resign effective as per the ordinary shareholders' meeting immediately following completion of his or her 70th year of age, even if the term of office has not yet expired. Newly elected members enter into the term of their predecessors.

Changes in the Board of Directors

Dr. Man and Mr. Scott have been re-elected as members of the Board of Directors, each for a term of three years, at the ordinary shareholders' meeting on April 12, 2005.

For an overview of the years of first election and of expiry of the current terms of each member of the Board of Directors, please refer to the chart on page 34.

Internal Organization and Areas of Responsibility

RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The Board of Directors is entrusted with the ultimate direction of Basilea and the supervision of management. The Board of Directors' non-transferable and irrevocable duties include to ultimately manage the corporation and to issue the necessary directives, to determine the organization, to organize the accounting system, the financial controls as well as the financial planning and to appoint, recall and ultimately supervise the persons entrusted with the management and representation of Basilea. Furthermore, these duties comprise the responsibility for the preparation of the annual report and the shareholders' meeting, the carrying out of shareholders' resolutions and the notification of the judge in case of overindebtedness of Basilea.

In addition or specification of these duties, the Board specifically retains certain main decision-making competencies, including setting the strategy and short and long-term goals of Basilea; all M&A transactions as far as no shareholder approval is required; decisions on annual budgets; the general direction of research and development (e.g. therapeutic areas covered, areas of priority and third party co-operations); general policies in relation to personnel matters, including basic principles related to benefit and incentive plans; certain communication tasks towards shareholders and the public as required by applicable laws and regulations; and general policies on outsourcing versus internal functions for manufacturing, sales and marketing.

According to the Organizational Regulations, resolutions of the Board of Directors are passed by way of simple majority. To validly pass a resolution, more

than half of the members of the Board of Directors have to attend the meeting. No quorum is required for confirmation resolutions ("Feststellungsbeschlüsse") and adaptations of the Articles in connection with capital increases pursuant to articles 651a, 652g and 653g of the Swiss Code of Obligations.

CHAIRMAN OF THE BOARD OF DIRECTORS

The Chairman of the Board calls, prepares and chairs the meetings of the Board of Directors. The Chairman also chairs the shareholders' meetings. He supervises the implementation of the resolutions of the Board of Directors and generally supervises the CEO and his Management Committee, who regularly reports to the Chairman on the meetings of the Management Committee and on all important matters of the Company. The Chairman is also entitled to attend the meetings of the Management Committee. In urgent matters that do not allow for the Board of Directors to take resolutions in time, the Chairman is entitled to take decisions that fall within the competencies of the Board of Directors. The Vice-Chairman of the Board of Directors exercises the powers of the Chairman in the Chairman's absence.

BOARD COMMITTEES

The Board of Directors established an Audit Committee and a Compensation Committee in 2003. The tasks and responsibilities of these Committees are set forth in the Organizational Regulations. These Committees make proposals to the Board of Directors in their areas of responsibilities while the resolutions are passed by the Board of Directors. The Board determined to retain nomination responsibilities for the full Board of Directors.

Since its establishment, the **Audit Committee** consists of Andreas Wicki (chairman), Peter van Brummelen and Walter Fuhrer, who all are non-executive members of the Board of Directors. The Audit Committee assists the Board of Directors in fulfilling its duties of supervision of the management. It is responsible for the guidelines of Basilea's risk management and internal control system and the review of their adequacy and effectiveness, the review of the compliance, the assessment of the external auditors' quality and work and the review of their audit plans, the monitoring of the independence of external auditors (including the authorizing of nonaudit services by the auditors and their compliance with applicable rules), the proposal of new auditors, if necessary, to the Board of Directors, the review of annual and interim financial statements, the review of the audit results and the monitoring of the implementation of the findings by the Management Committee. The Audit Committee is at all times authorized to inspect the books and records of Basilea and to request information from and meetings with all management bodies and employees of Basilea as well as its external auditors.

The Audit Committee held 3 meetings in 2005, each with a duration of approximately one-half day. The main topics at these meetings were the review of the year-end financial statements and Annual Report 2004; the review of the half-year financial statements 2005; the review of the annual budget 2005 and 2006; risk management and the scope of the external audit 2005. The CFO was present at all Audit Committee meetings to report to the Audit Committee. In addition, the external auditors were present at 2 Audit Committee meetings in 2005 to report on the findings of the audit 2004 and the half-year review 2005.

Since its establishment, the **Compensation Committee** consists of Werner Henrich (chairman), Peter Friedli and Daniel Lew, who all are non-executive members of the Board of Directors. The Compensation Committee assists the Board of Directors in compensation-related matters. It provides the Board of Directors with recommendations on the compensation of the members of the Board of Directors and of the Management Committee, the policies for the compensation of the Management Committee and Basilea's other employees and the basic principles for the establishment, amendment and implementation of Basilea's stock option plan.

The Compensation Committee held 3 meetings in 2005 each with a duration of one or more hours. The main topics at these meetings included the review of the 2004 achievements versus the planned corporate objectives and determination of the performance-related bonus pool; the annual general salary increases; the grant of options; and the general remuneration of members of the Management Committee and employees. The CEO was present at a portion of all Compensation Committee meetings. The respective recommendations of the Compensation Committee were then further discussed for approval or modification by the full Board of Directors.

WORKING METHODS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

According to the Organizational Regulations, the Board of Directors must hold at least four meetings per year. When required, the Board of Directors holds ad hoc meetings or telephone conferences to discuss specific issues or passes resolutions by way of circulation.

In 2005, the Board of Directors held 5 meetings with an average duration of half a day. Except for one meeting, all were held at the offices of Basilea. The overall attendance rate (in person or by phone) was 100%.

The members of the Management Committee report to the Board of Directors at each board meeting on the status of operations, especially related to the progress of clinical development and research programs as well as the status of drug supply and licensing activities. In addition, an update is given at board meetings on the status of the Company's share price development.

The Board Committees report about their Committee meetings to the full Board of Directors at the board meeting following the relevant Committee meeting. Any resolutions on matters assigned to the Committees are taken by the Board of Directors on the basis of recommendations of the relevant Committee.

RESPONSIBILITIES OF THE MANAGEMENT COMMITTEE

In accordance with the Articles and the Organizational Regulations, the Board of Directors has delegated all areas of management of Basilea that are not reserved by law, the Articles or the Organizational Regulations, to the Board of Directors (see section "Responsibilities of the Board of Directors" on page 38), to the CEO and the Management Committee reporting to the CEO. The main duty of the CEO with the assistance of the Management Committee is to operationally manage the Company, to implement the strategies and other decisions of the Board of Directors, to make proposals to the Board of Directors regarding matters constituting decision-making competencies of the Board of Directors, to set the operative focus and priorities as well as to procure the necessary resources.

Information and Control Instruments of the Board of Directors

The Board meetings are the Board of Directors' main platform to supervise and control the management. At each board meeting, the CEO and CFO report on the financial, business, research and development status, with a particular focus on the main risks of the Company related to its key value drivers, respective measures taken and related strategic proposals. The Board of Directors from time to time also calls upon further members of the Management Committee and management to attend board meetings for reporting purposes.

In addition, management provides a monthly report to the Board of Directors on the status of operations and other issues that may be requested by the Board of Directors. The main components of this monthly report are the status of development and research programs as well as the status of the drug supply activities. Furthermore, management provides a monthly financial report to the Audit Committee including an unaudited consolidated balance sheet, profit and loss statement and statement of cash flows for the respective month. The financial report further includes comparisons of actual versus budget numbers.

The audited consolidated financial statements for the previous financial year are provided to the Audit Committee for their review at the end of January/beginning of February of each year. The consolidated interim financial statements for the half-year are provided to the Audit Committee at the end of July/beginning of August of each year. The financial statements are then recommended by the Audit Committee to the full Board of Directors at its subsequent meeting.

Furthermore, around November of each year, upon recommendation of the Audit Committee, the Board of Directors approves the annual budget of the Company for the following year. The Audit Committee reviews any budget changes as may occur from time to time related to strategic changes or opportunities. In the event the Audit Committee recommends any changes to the budget, the Board considers and may determine to approve such budget changes consistent with the strategy of the Company.

The Board of Directors additionally requests the auditors to issue a written report on any of their findings with respect to internal controls as a result of their audit procedures.



From left: Dr. Rienk Pypstra | Dr. Anthony Man | Prof. Jutta Heim | Mr. Ronald Scott

Management

Members, Functions and Other Activities

The Management Committee comprises four executives. Under the responsibility of the CEO and the control of the Board of Directors, it conducts the operational management of the Company pursuant to the Organizational Regulations and provides reports to the Board of Directors under the direction of the CEO at least on a monthly basis.

The following table sets forth the name, date of appointment and position of the current members of the Management Committee. In addition, a short description of each member's nationality, business experience, education and activities is outlined below.

Name	Appointed	Position
Dr. Anthony Man	2003	Chief Executive Officer
Ronald Scott	2000	Chief Financial Officer
Dr. Rienk Pypstra	2004	Chief Development Officer
Prof. Jutta Heim	2004	Chief Scientific Officer

For information on **Anthony Man**, Chief Executive Officer, and **Ronald Scott**, Chief Financial Officer, please refer to the section "Board of Directors" on page 34.

Jutta Heim, Chief Scientific Officer, born in 1951, is a German citizen and has a Ph.D. in biology. Prior to joining Basilea, she has worked for the past 22 years in Switzerland and in the United States for Ciba-Geigy (later Novartis) in various positions with increasing management responsibility. During her first years in the Ciba-Geigy Biotechnology Department, she was involved in the successful development and launch of biopharmaceutical anti-thrombotic and fibrinolytic products. At Novartis, she initiated a Molecular Genetics Department in oncology, prior to becoming the company's Senior Scientific Expert in Molecular Biology and a member of the Research Management Board. Most recently, she was heading the central Novartis Lead Discovery Center with worldwide responsibility. Jutta Heim has published numerous papers in the areas of natu-

ral products, recombinant proteins and applied molecular biology, in particular in the area of oncology. She holds a professorship in Biotechnology at the Bio-center of the University of Basel. She is on the board of directors of Evolva AG, Switzerland. Furthermore, she is a member of the scientific advisory board of PamGene, s-Hertogenbosch, Netherlands and of SpinX Technologies, Meyrin, Switzerland, both privately held biotechnology companies.

Rienk Pypstra, Chief Development Officer, MD, MBA, is a Dutch citizen, born in 1961 in Amsterdam. Following a period of medical practice, Dr. Pypstra joined Eli Lilly and later worked for SmithKline Beecham and GlaxoSmithKline, accumulating over 15 years of international pharmaceutical industry experience, primarily in the area of antibacterials. Dr. Pypstra provided strategic support for Smithkline Beecham's antibiotic business, adopting the emerging science of antibiotic pharmacokinetic/pharmacodynamic ("PK/PD") to optimise Augmentin formulations. He was also the director of the Alexander project, the first international longitudinal surveillance project of resistance in respiratory pathogens. Prior to joining Basilea in October 2003 as Anti-Infective Therapeutic Area Head, he was Global Head of Clinical Pharmacology for Antimicrobials and Host Defence at GlaxoSmithKline. In June 2004, he was appointed Chief Development Officer.

Management Contracts

There are no management contracts between Basilea and any third parties.

Former Activities for the Company

Changes in Management Committee

In 2005, there have been no changes in the Management Committee. For further information on former activities for the Company, please refer to the section "Board of Directors/Members, Functions and Other Activities" and "Management/Members, Functions and Other Activities".

Compensation, Shareholdings and Loans

Content and Method of Determining the Compensation and Share Option Program

The compensation of the members of the Board of Directors and of the Management Committee is set and reviewed annually by the Board of Directors, based on recommendations of the Compensation Committee in accordance with Basilea's compensation policies.

The compensation of the members of the Management Committee includes a base salary, as well as a bonus and stock options, both of which are based on personal and company performance. In addition, Basilea contributes to the pension plan and maintains certain insurances for death and invalidity.

The Board of Directors decides annually, based on the recommendation of the Compensation Committee, on the total amount of bonus to be granted based on the achievement of the Company goals set by the Board of Directors annually. These Company goals are related to the key value drivers of the Company, such as successful completion of clinical trials, providing drug supply for clinical trials, identification of clinical candidates and financing these activities. In a second step, the individual bonus for members of the Management Committee is determined by the Board of Directors upon recommendation of the Compensation Committee based on the individual performance and management's respective contribution to achieving the Company's goals.

The compensation of the members of the Management Committee and the members of the Board of Directors is reviewed yearly by the Compensation Committee. As part of this review, the Compensation Committee considers compensation packages at comparable companies in the industry based on the experience of the Committee members and publicly available information such that the Company remains competitive in its sector. This review forms the basis for the recommendation of the Compensation Committee to the Board.

In 2005, the Board of Directors amended the compensation package for non-executive members of the Board of Directors. As a consequence, the compensation package for non-executive board members consists of a fixed annual monetary compensation, a compensation based on meeting attendance and engagement in board committees as well as of stock options. In addition, Basilea reimburses Director's out-of-pocket expenses related to their engagement as members of the Board.

In 2005, each non-executive board member was granted 3,000 stock options, while the Chairman of the Board of Directors was granted 4,500 stock options. In addition, the non-executive board members obtained a fixed annual compensation for their board membership of CHF 25,000. Furthermore, each non-executive board member obtained a total meeting fee of CHF 25,000 (meeting fee of CHF 5,000 per meeting whereby the maximum cumulated meeting fee paid per year is limited to CHF 25,000). In addition, each non-executive board member acting as a member of the Audit or Compensation Committee obtained an annual one-time Committee fee of CHF 5,000. The Chairman of the Board of Directors received a fixed annual compensation of CHF 37,500, an annual Committee fee of CHF 7,500 and a meeting fee of CHF 7,500 per meeting whereby the maximum cumulated meeting fee paid is limited to CHF 37,500.

Executive members of the Board of Directors do not obtain any compensation for their participation in the Board of Directors.

Compensation for Acting and Former Members of Governing Bodies

For 2005, the aggregate compensation to the members of the Management Committee (including executive members of the Board of Directors) received amounts to CHF 1,810,496, including voluntary contributions to Basilea's pension plan, certain insurance policies as well as other fringe benefits. Mr. Scott received a total compensation of CHF 455,737, including voluntary contributions to Basilea's pension plan, certain insurance policies as well as other benefits, and 20,000 stock options. Please refer to the section "Highest Total Compensation" on page 47 for information of the compensation of Dr. Man.

The aggregate compensation to non-executive members of the Board of Directors for 2005 amounts to CHF 405,000.

No payments were made in 2005 to former members of governing bodies.



Share Allotments

No shares were granted by Basilea to any member of the Board of Directors or the Management Committee in 2005, nor were any shares granted to parties closely linked to members of the Board of Directors or the Management Committee in this period.

Shareholdings of Members of Governing Bodies

The shareholdings of the non-executive members of the Board of Directors as well as of the executive members of the Board of Directors and the members of the Management Committee, including parties closely linked to such persons, as of December 31, 2005, are shown in the following table:

	Total shares held as of Dec 31, 2005
Non-executive board members	470 650
Executive board members / Members of the Management Committee	2 000

These indications do not take into account the shares held by the significant shareholders F. Hoffmann-La Roche Ltd. and HBM BioVentures (Cayman) Ltd., in which non-executive members of the Board of Directors hold board, executive or similar positions. For information on activities and vested interests of the members of the Board of Directors, please refer to section "Board of Directors" on page 34, for information on significant shareholders please refer to section "Significant Shareholders" on page 30.

Options

The total number of stock options held by the non-executive members of the Board of Directors as well as by the executive members of the Board of Directors and the members of the Management Committee, including parties closely linked to such persons, as of December 31, 2005, is listed below:

Year of Option Grant	End of Option Term	Non-executive Directors	Executive directors and members of Management Committee
2000	Dec 2007	24 900	34 600
2001	Nov 2007	21 100	34 600
2002	Nov 2007	24 900	34 600
2003	Nov 2013	21 250	58 425
2004	Nov 2014	21 750	73 767
2005	Nov 2015	22 500	75 200
Total		136 400	311 192

Each option entitles the option holder to purchase one registered share of Basilea at the strike price, which is CHF 60 per option for the options granted up to December 31, 2003 and CHF 78.30 for the options granted in 2004. The strike price for the option granted in 2005 is CHF 139.20. For further information on the stock option plan and the options issued thereunder, please refer to note 11 "Stock-Based Compensation" of the Consolidated Financial Statements.

Shareholders Participation

Additional Fees and Remuneration

In addition to the compensation as Chairman of the Board of Directors, Mr. Henrich acted as consultant to Basilea in 2005 and received a total compensation of CHF 20,925 for his consulting services. Dr. Keller represents F. Hoffmann-La Roche Ltd., which provided certain services to Basilea in 2005. Please refer to note 15 "Related Party Transactions" in the Consolidated Financial Statements as of December 31, 2005 for further information in this respect.

None of the other members of the Board of Directors or of the Management Committee or parties closely linked to them received any fees or remunerations for additional services rendered to the Company in 2005.

Loans to Members of Governing Bodies

The Company has not granted any loans, guarantees, advances or credits to any member of the Board of Directors or of the Management Committee or to any party closely linked to any such person.

Highest Total Compensation

In 2005, Dr. Man received the highest total compensation in the amount of CHF 591,323, including voluntary contributions to Basilea's pension plan, certain insurance policies as well as other benefits, and 25,700 stock options.

Voting Rights and Representation Restrictions

Voting rights may be exercised only after a shareholder has been recorded in Basilea's share register ("Aktienbuch") as a shareholder or usufructuary ("Nutzniesser") with voting right. No exceptions from these restrictions have been granted in 2005.

At shareholders' meetings, shareholders can be represented by proxy by a third party who does not need to be a shareholder.

Subject to the registration of shares in the share register within the deadline set from time to time by the Board of Directors before shareholders' meetings, Basilea's Articles do not impose any restrictions on the voting rights of shareholders. Specifically, there is no limitation on the number of voting rights per shareholder. For further information on the conditions for registration in the share register (including in relation to nominees) and for attending and voting at a shareholders' meeting, please refer to the sections "Limitations on Transferability of Shares and Nominee Registrations" on page 32 above and "Registration in the Share Register" on page 49 above.

A shareholder resolution with a qualified majority of at least two-thirds of the share votes represented as well as the majority of the par values of the shares represented is required for the creation of shares with privileged voting rights.

Statutory Quorums

There is no provision in the Articles requiring a quorum for shareholders' meetings.

According to article 11 of the Articles, resolutions generally require the approval of the absolute majority ("absolute Mehr") of the share votes represented at the shareholders' meeting. Shareholders' resolutions requiring such a majority include amendments to the Articles (subject to the exceptions be-

low), elections of members of the Board of Directors, elections of the auditors and the group auditors, approvals of the annual report, the annual financial statements and consolidated financial statements of the group, decisions regarding dividends, decisions to discharge the members of the Board of Directors and the management from liability for matters disclosed to the shareholders' meeting and the ordering of an independent investigation into specific matters proposed to the shareholders' meeting ("Sonderprüfung").

Pursuant to article 12 of the Articles, a resolution passed at a shareholders' meeting with a qualified majority ("qualifiziertes Mehr") of at least two-thirds of the share votes represented as well as the majority of the par values of the shares represented is required for: (i) changes in Basilea's purpose; (ii) the creation of shares with privileged voting rights; (iii) restrictions on the transferability of registered shares; (iv) an authorized or conditional capital increase ("genehmigte oder bedingte Kapitalerhöhung"); (v) an increase of capital out of equity ("Kapitalerhöhung aus Eigenkapital"), against contributions in kind ("Sacheinlage") or for the purpose of an acquisition of assets ("Sachübernahme") and the granting of special benefits; (vi) the limitation or withdrawal of preferential subscription rights; (vii) the change of the registered offices of Basilea; and (viii) the dissolution of Basilea without liquidation (e.g. through merger). In addition, amendments of the clauses of the Articles of Basilea on transfer restrictions, on the conversion of registered shares into bearer shares as well as amendments to the clause relating to such additional items requiring a qualified majority also require the qualified majority mentioned before.

The shareholders' meeting may at any time convert registered shares into bearer shares or bearer shares into registered shares through an amendment of the Articles.

Convening of Shareholders' Meetings and Agenda Items

The shareholders' meeting is the supreme institution of Basilea. Under Swiss law, the ordinary shareholders' meeting takes place annually within six months after the close of the business year. Shareholders' meetings may be convened by the Board of Directors or, if necessary, by the auditors. The Board of Directors is furthermore required to convene an extraordinary shareholders' meeting if so requested in writing by holders of shares representing at least 10% of the share capital of Basilea, setting forth the items to be included on the agenda and the proposals. Shareholders representing shares with a par value of at least CHF 100,000 have the right to request in writing that an item be included on the agenda of the next shareholders' meeting, setting forth the item and the proposals. According to article 7 of the Articles, the request to put an item on the agenda has to be made at least 45 days prior to the shareholders' meeting. Extraordinary shareholders' meetings can be called as often as necessary, in particular in all cases required by law.

Shareholders' meetings have to be convened by publishing a notice in the Swiss Official Gazette of Commerce ("Schweizerisches Handelsamtsblatt") at least 20 days prior to such meeting. In addition, holders of registered shares may be informed by a letter sent to the address indicated in the share register.

Registration in the Share Register

The Board of Directors determines the relevant deadline for registration in the share register giving the right to attend and to vote at the shareholders' meeting ("Stichtag"). Such deadline is published by Basilea in the Swiss Official Gazette of Commerce and the Company's website, usually in connection with the publication of the invitation to the shareholders' meeting. In case that such deadline for the ordinary annual shareholders' meeting is already determined by the Board of Directors prior to the printing of the Annual Report, it will also be included in the Annual Report.

In 2005, the deadline for registration in the share register in order to participate and vote at the ordinary shareholders' meeting of April 12, 2005 was March 31, 2005, i.e. 12 days before the shareholders' meeting. It is Basilea's intention regarding future shareholders' meetings that this timeframe will not change significantly.

The registration deadline for the ordinary shareholders' meeting to be held on March 28, 2006, has been determined to be March 15, 2006.

Basilea has not enacted any rules on the granting of exceptions in relation to these deadlines. No exceptions have been granted in 2005 and the Board of Directors does not anticipate to grant any exceptions related to the shareholders' meeting on March 28, 2006.

For further information on the registration in the share register, please refer to the section "Limitations on Transferability of Shares and Nominee Registrations" on page 32 below.

Changes of Control and Defense Measures**Duty to Make an Offer**

The Articles contain no provision which would rule out the obligation of an acquirer of shares exceeding the threshold of 33¹/₃% of the voting rights to proceed with a public purchase offer (opting-out provision pursuant to article 22 para. 2 and 3 SESTA) or which would increase such threshold to 49% of the voting rights (opting-up provision pursuant to article 32 para. 1 SESTA).

Clauses on Changes of Control

Basilea's stock option plan contains provisions in respect of changes of Basilea's shareholder base. In case of a change of control over Basilea (defined as a change of control event triggering a mandatory public purchase offer according to applicable stock exchange provisions), all unexercised stock options of all option holders, including, but not limited to stock options held by members of the Board of Directors and of the Management Committee, vest and become exercisable. The related term of the stock options would be reduced in such an event.

Furthermore, upon a change of control, the provisions of the stock option plan cannot be changed to the detriment of their holders and Basilea will hold the option holders harmless for any income taxes or social security contributions that are due or may become due related to early vesting, exercise or exercisability of stock options.

These provisions would also apply to stock appreciation rights under Basilea's stock option plan, none of which have, however, been granted to date.

Upon a change of control, the periods of notice applicable to all employment contracts of the Company become twelve months in the event of termination.

No other change of control provision exists for the benefit of members of the Board of Directors or of the Management Committee.

Auditors

Duration of the Mandate and Term of Office of the Lead Auditor

The statutory and group auditors of Basilea are PricewaterhouseCoopers AG, Basel, Switzerland. PricewaterhouseCoopers AG has held the function of statutory auditor since inception of Basilea on October 17, 2000, and acts as group auditor since 2002. The lead auditor of Basilea since inception of Basilea is Mr. Ralph R. Reinertsen.

Auditing Fees

In 2005, PricewaterhouseCoopers AG and its affiliates charged the Company auditing fees in the amount of CHF 82,010.

Additional Fees

No additional fees have been paid to PricewaterhouseCoopers AG and its affiliates in 2005.

Supervisory and Control Instruments pertaining to the Audit

The Audit Committee of the Board of Directors assumes the task of supervising the auditors. The Audit Committee meets with the external auditors at least once a year to discuss the scope and the results of the audit and to assess the quality of their services.

In 2005, the Audit Committee met with the auditors twice to discuss the scope and results of their year-end audit for 2004, the scope of the 2005 audit as well as the results of their review of the half-year financial statements per June 30, 2005.

Information Policy

Basilea publishes financial results on a biannual basis in form of an Annual Report and a Half-year Report (Interim Report). In addition, Basilea informs shareholders and the public regarding the Company's business through press releases, conference calls, as well as roadshows. Where required by law or Basilea's Articles, publications are also made in the Swiss Official Commercial Gazette.

The Annual Report, usually published no later than in April of the following year, and the Interim Report, usually published in August, are both announced by press release. Basilea intends to publish more precise information about the release date of the Annual Report on its website (www.basilea.com) in January of the respective year and June for the Interim Report of the respective half-year.

Annual Reports are provided in printed form to all registered shareholders upon their disclosure. Upon disclosure, Annual Reports, Interim Reports and press releases can be obtained free of charge in either German or English language versions on request, and are also made available on the Company's website at www.basilea.com. The Company's website, which is the Company's permanent source of information, also provides other information useful to investors and the public, including information on the Company's development and research programs as well as contact information.

It is the Company's policy not to release explicit earnings projections, but it will provide general guidance to enable the investment community and the public to better evaluate the Company and its business prospects for future performance. The Board of Directors has issued a disclosing policy to make sure that the investors will be informed in compliance with the requirements of the SWX Exchange.

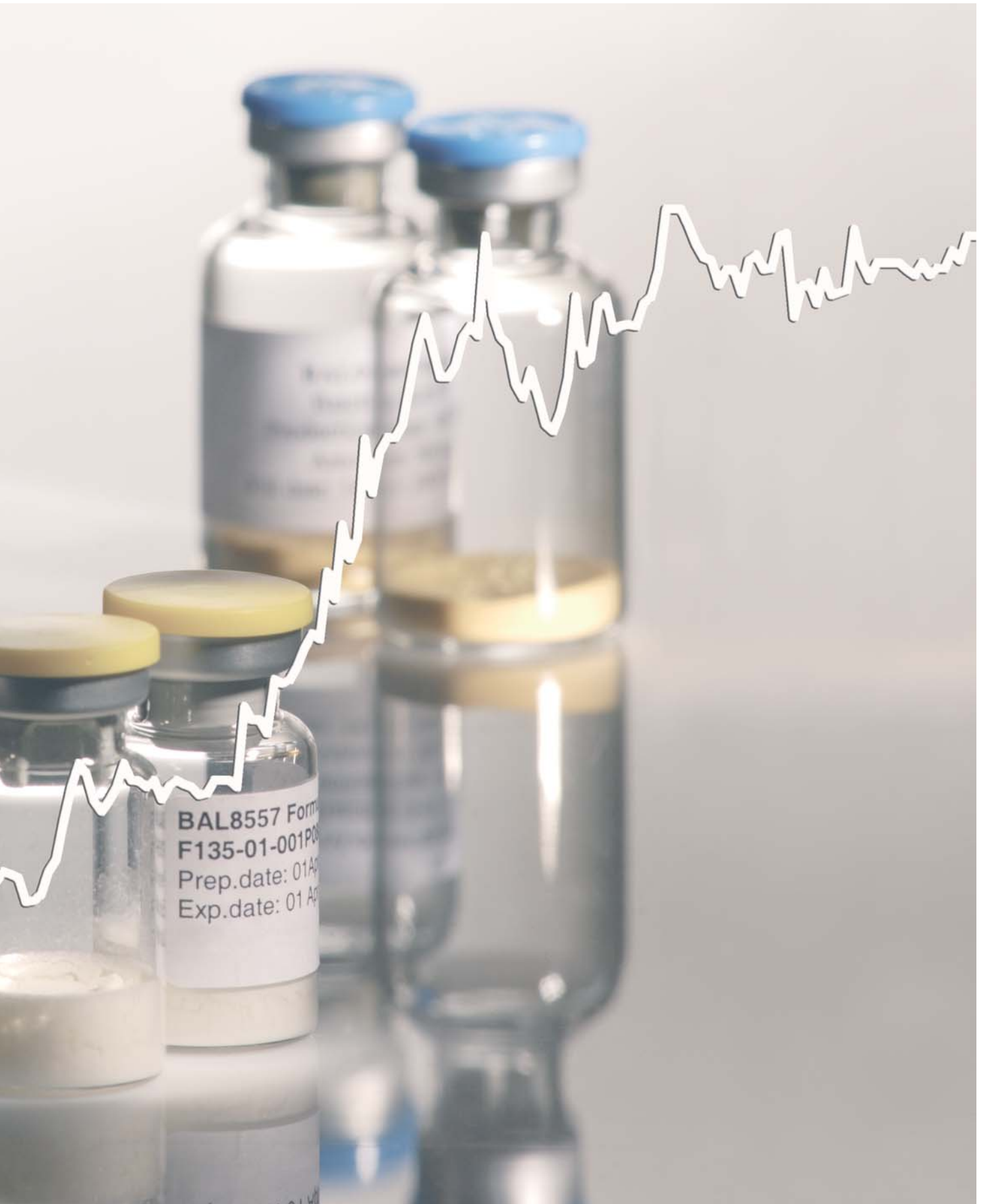
The Company's investor relations department is available to respond to shareholders' or potential investors' queries under investor_relations@basilea.com or via post at Basilea Pharmaceutica AG, Investor Relations, P.O. Box, CH-4005, Basel, Switzerland.

Additional inquiries may also be made by phone at +41 61 606 1111 or Investor Relations at +41 61 606 1233.

Insider Policy

The Board of Directors issued an insider policy in order to prevent insiders from benefiting from confidential information. The policy defines guidelines on how to deter corporate insiders from making use of confidential information. The Board of Directors has established blocking periods to prevent insiders from trading during sensitive periods.





Financial Review

Overview

The following discussion of the financial condition and results of operations of Basilea Pharmaceutica Ltd. should be read in conjunction with the consolidated financial statements, which have been prepared in accordance with US GAAP, and the related notes thereto included elsewhere in this Annual Report. This discussion contains forward-looking statements, which are based on assumptions about the Company's future business that involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements.

Basilea Pharmaceutica Ltd. is an independent biopharmaceutical company actively engaged in the discovery and development of innovative drugs for the treatment of bacterial infections, fungal infections and skin diseases associated with high unmet medical needs.

In February 2005, the Company entered into an exclusive worldwide agreement with Cilag GmbH International, a Johnson & Johnson company, to develop, manufacture and commercialize ceftobiprole, Basilea's novel broad-spectrum cephalosporin antibiotic that has activity against methicillin-resistant *Staphylococcus aureus* (MRSA). Ceftobiprole is in phase III clinical trials in complicated skin and skin structure infections and hospital-acquired pneumonia. Under this agreement, the Company received significant payments from Johnson & Johnson in 2005 totalling CHF 102.9 million resulting in a significant improvement in operating cash-flows compared to 2004. As of December 31, 2005, the Company recognized deferred revenue of CHF 73.9 million related to the upfront and milestone payments received under its license agreement with Johnson & Johnson.

In December 2005, Basilea gained global marketing and manufacturing rights to its antifungal, BAL8557, following Roche's decision not to exercise its option right. BAL8557 is planned to enter phase III development in 2006.

The cash and cash equivalents and short-term investments amounted to CHF 229.6 million as of December 31, 2005 compared to CHF 203.2 million at year-end 2004.

The research and development expenses in 2005 amounted to CHF 72.4 million, which primarily reflects the conduct of the alitretinoin (BAL4079) phase III trials, the phase II trials for BAL8557, plus certain phase III cost of ceftobiprole that were reimbursed by Johnson & Johnson.

The general and administrative expenses amounted to CHF 8.9 million or approximately 11% of total operating expenses in 2005.

Results of Operations

The following table outlines the Company's consolidated results of operations for the fiscal years 2005 and 2004:

In CHF million	2005	2004
Revenues	30.5	0.3
Research & development expenses	(72.4)	(68.9)
General & administrative expenses	(8.9)	(7.1)
Total operating expenses	(81.3)	(76.0)
Operating loss	(50.8)	(75.7)
Net financial income	1.2	0.2
Loss before taxes	(49.6)	(75.5)

Revenues

Under the license agreement with Johnson & Johnson, the Company received payments totalling CHF 102.9 million in 2005, including CHF 78.0 million in upfront and milestone payments. The upfront and milestone payments are recorded as deferred revenue and recognized as revenue on a straight-line basis over the term of the agreement. In 2005, the Company has recognized revenues of CHF 4.1 million related to these upfront and milestone payments. In addition, the Company recognized revenues of CHF 24.9 million related to the reimbursement of expenses, sale of clinical material and intermediates as well as services provided under this agreement.

Research and Development

The research and development expenses amounted to CHF 72.4 million in 2005, representing 89% of the total operating expenses (2004: 91%).

The research and development expenses in 2005 were incurred in connection with the conduct of the alitretinoin (BAL4079) phase III trials and the phase II trials for the Company's antifungal, BAL8557, which were successfully completed in 2005. In addition, the Company recorded the phase III development expenses for ceftobiprole in 2005 until the development activities and the responsibility for the development expenses were transferred to Johnson & Johnson. Furthermore, expenses were incurred for the Company's topical antibiotic for the treatment of acne, BAL19403, which entered into pre-clinical development in 2005 as well as for the Company's research projects.

The research and development expenses primarily contain costs for third-party services in connection with clinical trials and research projects, costs for producing substance to be used in such trials and projects, personnel expenses for the research and development groups of the Company as well as depreciation of equipment used for its research and development activities.

General and Administrative Expenses

The general and administrative expenses amounted to CHF 8.9 million or approximately 11% (2004 : 9%) of total operating expenses in 2005.

General and administrative expenses mainly consist of costs related to corporate management, finance, human resources, business development, licensing and investor relations, including personnel expenses for these functions.

Net Financial Income

Net financial income increased to CHF 1.2 million in 2005 compared to CHF 0.2 million in 2004. This change mainly resulted from the increase of funds available for investments compared to the prior year as well as from reduced interest expenses in 2005, as the Company repaid its mortgage in the amount of CHF 10.0 million in May 2005.

Income Taxes

Due to the losses incurred to date, the Company has not paid any income taxes.

Liquidity and Capital Resources

As of the date of inception of Basilea, the Company had available cash funds in the amount of CHF 206.0 million as a result of an initial capital contribution from Roche. In June 2003, Basilea performed a capital increase, in which Basilea raised net proceeds of CHF 20.7 million through the issuance of new shares in a private placement. In March 2004, Basilea issued 2.1 million registered shares in connection with its initial public offering and raised net proceeds of CHF 192.8 million. In 2005, the Company received payments under its license agreement with Johnson & Johnson in the total amount of CHF 102.9 million.

The cash used by the Company in 2005 was primarily related to its operating activities, in particular the research and development programs. In addition, the Company repaid its mortgage in the amount of CHF 10.0 million in May 2005.

The cash and cash equivalents and short-term investments, available as of December 31, 2005, amount to CHF 229.6 million.

The Company's policy is to invest its available funds in low risk investments, including interest-bearing deposits, bonds and other debt instruments. As of December 31, 2005, CHF 200.0 million were invested in short-term bank deposits denominated in Swiss Francs.

The Company has not entered and has not planned to enter into any commitments for any material investments other than for investments in the normal course of the business.

The financial needs of BPh Investitionen Ltd. and Jiangsu Innovative New Drug Research Center Co. Ltd., the two wholly owned and fully consolidated subsidiaries of Basilea, are exclusively covered by the Company. Neither subsidiary had any third-party debt outstanding as of December 31, 2005.

Critical Accounting Policies

The consolidated financial statements of the Company have been prepared in accordance with US GAAP. The preparation of the financial statements requires management to make estimates and assumptions which have an effect on the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and on the reported amounts of revenues and expenses during the reporting period. These estimates are based on managements' knowledge of current events and actions the Company may undertake in the future, however, actual results ultimately may differ from those estimates.

The upfront and milestone payments received under the license agreement for ceftobiprole were recorded as deferred revenue and are recognized over the term of the agreement in accordance with the Company's policy on revenue recognition.

In 2005, the Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 123R related to accounting for stock-based compensation. As a result, starting from July 1, 2005, stock options are measured based on the grant-date fair value of the award. The adoption of SFAS No. 123R resulted in additional compensation expenses in 2005 of approx. CHF 2.7 million.

Please refer to the Consolidated Financial Statements of the Company included elsewhere in this Annual Report for further information on the Company's accounting policies.

Foreign Currency Exchange Rate Risk

The functional currency of the Company is Swiss Francs, in which most of its expenses are incurred. The Company's expenses are also incurred in foreign currencies, especially in Euro, US dollars, British pounds and Chinese yuan renminbi. Although the Company believes that the current exposure to foreign currency risk is not significant, it cannot be excluded that unfavorable developments of the value of the Swiss franc could have a material adverse effect on the Company's business, financial condition, results of operations and prospects in the future.

As one of Basilea's subsidiaries is located in China, the value of the assets and liabilities of this subsidiary is translated into Swiss francs for purposes of the Company's consolidated financial statements. Consequently, the values of these assets and liabilities are subject to foreign currency fluctuations. However, due to the limited relative book value of the assets and liabilities involved in the Chinese subsidiary, the related exposure to foreign currency risk is not deemed to be significant for the Company.

Recent Developments

There have been no material adverse changes in the business or financial situation of the Company since December 31, 2005.

**Report of the
Group Auditors**



Report of the Group Auditors to the General Meeting of Shareholders of
Basilea Pharmaceutica AG, Basel, Switzerland

As Group auditors of Basilea Pharmaceutica AG and its subsidiaries, we have audited the accompanying consolidated balance sheets as of December 31, 2005 and 2004 and the related consolidated statements of operations, cash flows and changes in shareholders' equity for each of the years then ended, included on pages 59 to 75. These consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America, as described in Note 1.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We confirm that we meet the Swiss legal requirements concerning professional qualification and independence.

We conducted our audits of these consolidated financial statements in accordance with Swiss Auditing Standards and with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Basilea Pharmaceutica AG and its subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America, and comply with the relevant Swiss law.

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

PricewaterhouseCoopers AG

Ralph R. Reinertsen

Garrett C. Thompson

Basel, February 16, 2006

Consolidated Financial Statements
Basilea Pharmaceutica Ltd. and subsidiaries
Consolidated Balance Sheets as of December 31, 2005 and 2004 (in CHF)

ASSETS	Footnote reference	2005	2004
Current assets			
Cash and cash equivalents		29 635 274	66 918 453
Short-term investments	6	200 000 000	136 250 000
Accounts receivable	5	437 730	70 943
Other receivables		529 518	585 021
Accrued interest		949 281	474 606
Other current assets		776 966	1 496 298
Total current assets		232 328 769	205 795 321
Non-current assets			
Property, plant and equipment, net	3	19 792 420	21 737 027
Other non-current assets	14	3 442 000	3 249 000
Total non-current assets		23 234 420	24 986 027
TOTAL ASSETS		255 563 189	230 781 348
LIABILITIES			
Current liabilities			
Accounts payable		854 371	2 000 459
Short-term debt	8	–	10 365 868
Deferred revenue	7	5 541 207	–
Accruals and other current liabilities	9	12 626 394	8 795 508
Total current liabilities		19 021 972	21 161 835
Non-current liabilities			
Deferred revenue, less current portion	7	68 671 971	–
Long-term debt	8	–	19 109
Total non-current liabilities		68 671 971	19 109
Total liabilities		87 693 943	21 180 944
SHAREHOLDERS' EQUITY			
Share capital ¹	12	7 436 502	7 380 954
Additional paid-in capital		425 976 934	418 729 970
Accumulated other comprehensive loss		(609 252)	(1 171 305)
Loss carried forward		(215 339 215)	(139 867 172)
Net loss		(49 595 723)	(75 472 043)
Total shareholders' equity		167 869 246	209 600 404
TOTAL LIABILITIES AND EQUITY		255 563 189	230 781 348

¹ As of December 31, 2005, 7,436,502 shares issued and outstanding at par value of CHF 1 per share.
As of December 31, 2004, 7,380,954 shares issued and outstanding at par value of CHF 1 per share.

These financial statements should be read in conjunction with the accompanying notes.

Basilea Pharmaceutica Ltd. and subsidiaries

Consolidated Statements of Operations for the years ended December 31, 2005 and 2004 (in CHF)

	2005	2004
Revenues	30 494 924	286 704
Research & development expenses	(72 395 130)	(68 920 909)
General & administrative expenses	(8 939 760)	(7 083 960)
Total operating expenses	(81 334 890)	(76 004 869)
Operating loss	(50 839 966)	(75 718 165)
Interest expense	(157 437)	(442 418)
Interest income	1 787 532	782 792
Other financial expenses, net	(385 852)	(94 252)
Loss before taxes	(49 595 723)	(75 472 043)
Income taxes	-	-
Net loss	(49 595 723)	(75 472 043)

Loss per share	2005	2004
Basic and diluted loss per share, in CHF	(6.71)	(10.93)

These financial statements should be read in conjunction with the accompanying notes.

Basilea Pharmaceutica Ltd. and subsidiaries**Consolidated Statements of Cash Flows for the years ended December 31, 2005 and 2004 (in CHF)**

	2005	2004
Cash flow from operating activities		
Net loss	(49 595 723)	(75 472 043)
Adjustments to reconcile net loss to net cash provided by/used for operating activities:		
Depreciation and amortization	3 569 349	4 531 061
Gain on disposal of assets, net	(141 735)	(89 194)
Stock-based compensation	3 975 470	2 496 915
Change in operating assets/liabilities		
- Accounts receivable	(366 787)	(32 106)
- Other receivables	56 289	454 235
- Accrued interest	(474 675)	(474 606)
- Other current assets	722 591	(962 616)
- Other non-current assets	(193 000)	321 000
- Accounts payable	(1 157 904)	1 078 365
- Deferred revenue	74 213 178	-
- Accruals and other current liabilities	3 773 118	3 945 059
Net cash provided by/used for operating activities	34 380 171	(64 203 930)
Cash flow from investing activities		
Short-term investments	(63 750 000)	(135 000 000)
Proceeds from sale of assets	188 274	263 487
Investments in property, plant & equipment	(1 200 914)	(440 404)
Net cash used for investing activities	(64 762 640)	(135 176 917)
Cash flow from financing activities		
Net proceeds from exercise of stock options	3 327 042	48 780
Repayment of mortgage	(10 000 000)	-
Repayment of capital lease liabilities	(384 977)	(531 519)
Net proceeds from capital increase	-	192 784 622
Purchase of treasury shares	-	(201 394)
Net cash provided by/used for financing activities	(7 057 935)	192 100 489
Effect of exchange rate changes on cash and cash equivalents	157 225	(100 454)
Net change in cash and cash equivalents	(37 283 179)	(7 380 812)
Cash and cash equivalents, beginning of period	66 918 453	74 299 265
Cash and cash equivalents, end of period	29 635 274	66 918 453
Supplemental information		
Cash paid for interest	(157 437)	(442 418)
Treasury shares issued for stock-based compensation	-	(151 500)

These financial statements should be read in conjunction with the accompanying notes.

Basilea Pharmaceutica Ltd. and subsidiaries
Consolidated Statement of changes in Shareholders' Equity
for the years ended December 31, 2005 and 2004 (in CHF, except for number of shares)

	Number of shares	Share capital	Additional paid-in capital	Loss carried forward	Accumulated other comprehensive income/loss	Total
Balance at						
December 31, 2003	5 280 141	5 280 141	225 701 861	(139 867 172)	(825 369)	90 289 461
Currency translation adjustment	-	-	-	-	(345 936)	(345 936)
Net loss	-	-	-	(75 472 043)	-	(75 472 043)
Comprehensive income/loss	-	-	-	(75 472 043)	(345 936)	(75 817 979)
Exercise of stock options, net	813	813	47 967	-	-	48 780
Stock-based compensation, net	-	-	2 345 414	-	-	2 345 414
Loss from treasury share transactions	-	-	(49 894)	-	-	(49 894)
Capital increase	2 100 000	2 100 000	190 684 622	-	-	192 784 622
Balance at						
December 31, 2004	7 380 954	7 380 954	418 729 970	(215 339 215)	(1 171 305)	209 600 404
Currency translation adjustment	-	-	-	-	562 053	562 053
Net loss	-	-	-	(49 595 723)	-	(49 595 723)
Comprehensive income/loss	-	-	-	(49 595 723)	562 053	(49 033 670)
Exercise of stock options, net	55 548	55 548	3 271 494	-	-	3 327 042
Stock-based compensation, net	-	-	3 975 470	-	-	3 975 470
Balance at						
December 31, 2005	7 436 502	7 436 502	425 976 934	(264 934 938)	(609 252)	167 869 246

These financial statements should be read in conjunction with the accompanying notes.

**Basilea Pharmaceutica Ltd.
and subsidiaries****Notes to the Consolidated
Financial Statements
(all amounts in CHF)****1 Summary of Significant Accounting Policies****BUSINESS PURPOSE AND HISTORY**

Basilea Pharmaceutica Ltd., Basel, Switzerland ("Basilea"), together with its subsidiaries (collectively "the Company"), is an independent biopharmaceutical company actively engaged in the discovery and development of innovative drugs for the treatment of bacterial infections, fungal infections and skin diseases associated with high unmet medical needs. The Company was founded in October 2000 as a wholly-owned subsidiary of F. Hoffmann-La Roche Ltd., Basel, Switzerland ("Roche"). Subsequently, Roche sold the majority of the Company's shares to other investors.

Upon inception, Roche assigned patents and royalty-free exclusive licenses to the Company in the areas of anti-infectives and dermatology.

Basilea owns 100% of the shares of BPh Investitionen AG, Baar, Switzerland, a subholding company, which holds a 100% investment in Jiangsu Innovative New Drug Research Center Co. Ltd., Haimen, China, that performs chemical supply research & development services.

BASIS OF PRESENTATION

The consolidated financial statements of the Company have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America ("US GAAP"). The financial statements are presented in Swiss Francs (CHF).

PRINCIPLES OF CONSOLIDATION

Subsidiaries in which Basilea has a controlling interest directly or indirectly are consolidated. Investments in which the Company exercises significant influence (generally between 20 and 50 percent of the voting rights), but which the Company does not control, are accounted for applying the method of equity accounting. Investments in which the Company does not exercise significant influence (generally ownership of less than 20 percent of voting rights) are accounted for at cost. Intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of financial statements in accordance with US GAAP requires management to make estimates and assumptions which have an effect on the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and on the reported amounts of revenues and expenses during the reporting period. These estimates are based on managements' knowledge of current events and actions the Company may undertake in the future, however, actual results ultimately may differ from those estimates.

CASH AND CASH EQUIVALENTS

The Company considers cash equivalents to be investments, which are highly liquid, readily convertible to cash with original maturities of not more than three months.

FOREIGN CURRENCIES

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses from the settlement of

such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of operations.

For consolidation purposes, income, expenses and cash flows are translated at the average exchange rate during the period. Assets and liabilities are translated at the period-end exchange rate. The resulting translation adjustment is recorded as other comprehensive income/loss in shareholders' equity.

SHORT-TERM INVESTMENTS

Short-term investments include term deposits with banks with original maturities of more than three up to twelve months. These investments are carried at fair value. Gains and losses resulting from such investments are included as a component of other financial income/expense in the statement of operations.

ACCOUNTS RECEIVABLE

Accounts receivable are recorded at net realizable value after consideration of an allowance for doubtful accounts.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at cost less accumulated depreciation. Depreciation is determined on a straight-line basis over the estimated useful lives of the assets of approximately 20 years for buildings, 5 years for R&D equipment, 3-5 years for furniture and office equipment and 3 years for IT hardware and software. Land-use rights are depreciated over the term of the granted right.

Whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable, the Company assesses its long-lived assets for impairment. An impairment loss is recognized where an impairment review indicates that the sum of future cash flows, on an undiscounted basis, expected to result from the use of the asset and its eventual disposition is less than the carrying amount of the asset. In this case, an impairment is recognized to the extent the carrying value of the asset exceeds its fair value.

LEASES

Property, plant and equipment acquired through capital lease arrangements are recorded at the lower of the present value of the minimum lease payments or fair value. These assets are depreciated over the shorter of the useful life of the assets or the lease term.

REVENUE RECOGNITION

The Company generally recognizes revenue if the criteria of Staff Accounting Bulletin ("SAB") No. 101, as amended by SAB No. 104, are met, which is when there is evidence of an arrangement, the price is fixed or determinable, collectibility is reasonably assured and the service has been rendered or delivery has occurred. For agreements with multiple deliverables, the Company recognizes revenue separately for each deliverable in accordance with EITF 00-21.

Revenue from non-refundable, upfront license fees and milestone payments under licensing agreements, where the Company has continuing involvement, is recognized over the estimated performance or agreement period, depending on the terms of the agreement. Performance based milestone payments are recognized upon achievement of the respective event and if there is no contin-

uous involvement by the Company related to this milestone payment. To the extent that the Company receives payments, including non-refundable payments, in excess of the recognized revenue, such excess is recorded as deferred revenue until the respective revenue is earned.

Revenue for research and development services provided by the Company is recorded as earned based on the performance requirements of the underlying contracts.

Payments received as reimbursement of expenses incurred by the Company, for which the Company was the primary obligor at the time the expenses incurred, are recognized as revenue in accordance with EITF 01-14.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development costs are expensed as incurred. Research and development equipment with alternative future uses is capitalized and depreciated over its respective useful life.

Research and development expenses primarily contain costs for third-party services in connection with clinical trials and research projects, costs for producing substance to be used in such trials and projects, personnel expenses for the research and development groups of the Company as well as depreciation of equipment used for its research and development activities.

STOCK-BASED COMPENSATION

As of July 1, 2005, the Company adopted the Statement of Financial Accounting Standards ("SFAS") No. 123R related to Accounting for Stock-Based Compensation. According to SFAS No. 123R, the Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Under the modified prospective application method of SFAS No. 123R, the Company applies this accounting treatment to awards issued, modified, repurchased or cancelled after June 30, 2005 as well as to portion of awards, to the extent they have not vested by June 30, 2005. The amounts recorded for stock-based compensation in periods prior to July 1, 2005, the adoption date of SFAS No. 123R, have not been restated and do not reflect the effects of this change in accounting policy.

For periods prior to July 1, 2005, the Company applied Accounting Principles Board ("APB") Opinion No. 25. Under APB Opinion No. 25, the Company recorded compensation expenses in connection with stock-based compensation awards based on the difference between the exercise price of the award and the market value of the underlying shares at the measurement date of such award.

The stock-based compensation expenses are allocated over the vesting period of the award. For awards, which consist of portions with different vesting periods, the compensation expense is recognized pro rata for each portion of the award over the respective vesting period of such portion.

Pro forma disclosure

The pro forma net loss and loss per share for 2005 and 2004 have been determined as if the Company had used the fair value method of accounting for its stock option grants in accordance with the provisions of SFAS No. 123 and No. 148 for periods prior to July 1, 2005.

The following table illustrates the effect on net loss and loss per share in 2005 and 2004, if the fair value based method had been applied in connection with the accounting for stock options in the periods prior to July 1, 2005:

In CHF million, except per share data	2005	2004
Net loss, as reported	(49.6)	(75.5)
+ Stock-based compensation included in reported net loss, net of tax	4.0	2.3
- Stock-based compensation determined under fair value based method, net of tax	(6.2)	(2.7)
Pro forma net loss (fair value method)	(51.8)	(75.9)
Per share data:		
Basic and diluted loss per share, as reported, in CHF	(6.71)	(10.93)
Basic and diluted loss per share, pro forma, in CHF	(7.01)	(10.99)

INCOME TAXES

The Company applies the asset and liability method for the determination of provisions for income taxes. The income taxes for the reporting period consist of the current taxes (taxes paid and taxes payable) plus the change in the deferred taxes for the respective period. Deferred taxes represent the estimated future tax consequences of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

EARNINGS/LOSS PER SHARE

Basic earnings/loss per share is calculated by dividing the net income/loss attributable to the shareholders by the weighted average shares outstanding during the period.

Diluted earnings/loss per share is calculated by dividing the net income/loss attributable to the shareholders by the weighted average shares outstanding during the period adjusted for potential dilution that could occur if dilutive securities, such as stock options and convertible debt, were exercised or converted into shares or resulted in the issuance of shares that then shared in the earnings/loss of the Company.

CERTAIN RISKS AND UNCERTAINTIES

The Company is subject to risks common to companies in its industry, including, but not limited to, uncertainty of results of clinical trials for its compounds; ability to achieve regulatory approval for its compounds; acceptance of Company's products by the market, once they are marketed; ability to market its products; ability to manufacture its products at reasonable costs; protection of proprietary technology; development of new technological innovations by its competitors; dependence on key personnel; dependence on key suppliers; and compliance with governmental and other regulations.

2 Exchange Rates of Principal Currencies

The exchange rates used for the consolidation in 2005 and 2004 were the following:

	Statement of Operations		Balance Sheet	
	Average rate		Period-end rate	
	2005	2004	2005	2004
US Dollar	1.25	1.24	1.32	1.13

3 Property, Plant and Equipment

In CHF million	Land/Land-use rights 2005	Buildings 2005	Machinery & Equipment 2005	Total 2005	Total 2004
Cost					
Jan 1	1.4	17.3	17.9	36.6	37.0
Additions	0.0	0.0	1.2	1.2	0.4
Disposals	0.0	0.0	(0.1)	(0.1)	(0.4)
Currency effect	0.0	0.3	0.4	0.7	(0.4)
Dec 31	1.4	17.6	19.4	38.4	36.6
Accumulated depreciation					
Jan 1	0.0	2.1	12.8	14.9	10.7
Additions	0.0	0.9	2.7	3.6	4.5
Disposals	0.0	0.0	0.0	0.0	(0.2)
Currency effect	0.0	0.0	0.1	0.1	(0.1)
Dec 31	0.0	3.0	15.6	18.6	14.9
Net book value	1.4	14.6	3.8	19.8	21.7

The insurance value of the property, plant and equipment amounts to CHF 86.6 million as of December 31, 2005.

4 Segment and Geographic Information

The Company operates in one segment, which is the discovery and development of pharmaceutical products. The CEO of the Company reviews the profit and loss of the Company on an aggregated basis and manages the operations of the Company as a single operating segment.

The geographical allocation of the long-lived assets of the Company is presented in the following table:

In CHF million	2005	2004
Switzerland	16.8	18.8
China	3.0	2.9
Total	19.8	21.7

In 2005 and 2004, all revenues were generated in Switzerland.

5 Accounts Receivable

The accounts receivable result primarily from contract research and development services provided by the Company. No allowance for doubtful accounts was recorded on the receivables in 2005 and 2004.

6 Short-Term Investments and Financial Instruments

SHORT-TERM INVESTMENTS

The short-term investments as of December 31, 2005 contain short-term deposits with banks, all denominated in Swiss Francs, in the amount of CHF 200.0 million (December 31, 2004: CHF 136.3 million).

FINANCIAL INSTRUMENTS

The book values of the short-term financial assets and liabilities, including cash and cash equivalents, short-term investments, accrued interest and accruals and other current liabilities, approximate the fair values due to the short-term nature of these positions.

7 Licensing Agreement

In February 2005, Basilea Pharmaceutica Ltd. entered into a royalty-bearing licensing, development and co-promotion agreement with Cilag GmbH International, Zug, Switzerland ("Licensee"), a subsidiary of Johnson & Johnson, under which the Company grants the Licensee an exclusive worldwide license to develop and commercialize the Company's antibiotic compound ceftobiprole (BAL5788). The Company retains the option to co-promote ceftobiprole in major market countries.

Under this agreement, the Company is eligible for a non-refundable upfront payment and non-refundable milestone payments based on the achievement of milestones related to development, regulatory filing, regulatory approval and commercialization of ceftobiprole. In addition, the Company is also eligible for royalty payments in the event of commercialization of ceftobiprole.

In 2005, the Company received non-refundable upfront and milestone payments totalling CHF 78.0 million. These payments are recognized as revenue on a straight-line basis over the term of the agreement. The Company recognized CHF 4.1 million as revenue in 2005 related to these payments. Furthermore, the Company realized revenue under this licensing agreement in 2005 in the amount of CHF 24.9 million related to the reimbursement of expenses incurred by the Company for ceftobiprole, the sale of clinical material and intermediates to the Licensee as well as from services provided by the Company to the Licensee.

8 Short-Term and Long-Term Debt

The Company entered into a mortgage agreement with a bank in the amount of CHF 10.0 million in connection with the acquisition of land and buildings in Basel, Switzerland, in 2002. The mortgage bearing fixed interest of 4.25% p.a. expired and was repaid by the Company in May 2005. The mortgage was secured with a lien on the land and building acquired. The fair value of the mortgage approximated its book value.

In addition, the Company repaid the remaining capital lease liabilities in 2005.

9 Accruals and Other Current Liabilities

Accruals and other current liabilities as of December 31, 2005 and 2004 consisted of the following:

In CHF million	2005	2004
Accrued R&D expenses	8.5	5.7
Accrued personnel and compensation costs	3.2	2.6
Other	0.9	0.5
Total accruals and other current liabilities	12.6	8.8

10 Income Taxes

The Company has tax loss carryforwards of CHF 262.5 million as of December 31, 2005 (December 31, 2004: CHF 214.3 million) of which CHF 83.9 million will expire within the next five years and CHF 178.6 million will expire between six and eight years.

The significant components of net deferred taxes as of December 31, 2005 and 2004 are shown in the following table:

In CHF million	2005	2004
Deferred tax assets:		
Net benefit from tax loss carryforwards	65.3	53.4
Other, net	0.6	0.4
Valuation allowance	(65.9)	(53.8)
Net deferred taxes	0.0	0.0

The Company recorded a valuation allowance in 2005 and 2004 to reduce the net deferred taxes to zero in each year, as there is not sufficient positive evidence related to the realizability of the deferred tax assets.

The effective tax rate was zero for the years ended December 31, 2005 and 2004 and the Company did not pay any income taxes in 2005 and 2004. The expected tax rate for the years 2005 and 2004 was 25%. The following table shows the reconciliation between expected and effective tax rate:

In percent	2005	2004
Expected tax rate	25	25
Effect of net permanent differences ¹	(1)	–
Valuation allowance on deferred tax assets	(24)	(25)
Effective tax rate	0	0

¹ Items not deductible for tax purposes and items that are tax deductible, but do not represent expenses for financial reporting purposes.

11 Stock-Based Compensation

The Company has established a stock option plan effective on December 13, 2000, to provide incentives to directors, executives and employees with an opportunity to obtain stock options on registered shares of Basilea. The shareholders approved conditional capital of up to CHF 2.0 million comprising two million registered shares at a par value of CHF 1 per share, necessary for the issuance of shares upon the exercise of the options, of which CHF 1.9 million remained available as of December 31, 2005.

Each option entitles the participant to the purchase of one registered share at the strike price pursuant to the rules of the stock option plan. At the end of the option term, all unexercised options expire without value.

The vesting periods of the stock options granted since inception of the Company, which represent the requisite service periods, have ranged from one to five years with contractual terms between five and ten years. The stock option plan foresees accelerated vesting if there is a change of control as defined by the stock option plan.

The following table summarizes the activity under the stock option plan mentioned above:

	Weighted average exercise price (in CHF)	Number of options
Balance at December 31, 2003	60.00	1 000 000
Options granted	78.30	289 977
Options forfeited	60.00	(29 535)
Options exercised	60.00	(813)
Balance at December 31, 2004	64.21	1 259 629
Options granted	139.20	337 100
Options forfeited	85.20	(2 160)
Options exercised	60.51	(55 548)
Balance at December 31, 2005	80.74	1 539 021

The following table provides information on the options outstanding and the options exercisable as of December 31, 2005:

	Options exercisable plus options expected to vest ¹	Options exercisable
Number of options	1 526 906	823 521
Weighted-average exercise price in CHF	80.44	61.57
Weighted average remaining contractual life (in years)	6.1	3.5

¹ number of options considers expected forfeitures

Based on (a) the stock options exercisable as of December 31, 2005, including stock options expected to vest in the future and (b) the stock options exercisable as of December 31, 2005, the aggregate intrinsic values of such number of options were CHF 89.4 million and CHF 63.8 million, respectively. The exercise prices of the options granted in 2005 and 2004 equalled the market price of the shares at the respective grant date.

The weighted average grant-date fair values of options granted in 2005 and 2004 were CHF 42.76 per option and CHF 29.37 per option respectively. The total aggregate intrinsic value of stock options exercised during 2005 was CHF 3.8 million (2004: CHF 0.0 million). The total fair value of the stock options vested in 2005 was CHF 3.3 million (2004: CHF 1.2 million). The Company did not grant any shares to employees in 2005, while a total of 2,500 shares were granted to employees in 2004 with a total fair value of CHF 0.2 million.

The fair value of the stock options granted in 2005 was determined at the grant date using a binomial model, while the Black Scholes model was used to determine the fair value of stock options granted in 2004. The assumptions used for these determinations are outlined in the table below:

	2005	2004
Risk-free interest rate	2.5%	1.6%
Expected term of stock options	4 years	4 years
Expected volatility	42%	46%
Expected dividend	–	–

The expected volatility was determined based on the historic volatility of the Company's share price. In addition, as the Company's history of share prices is limited, such historic volatility was adjusted based on historic volatilities of comparable companies. The expected term of stock options granted was determined based on managements' best estimate of assumed future exercise patterns, considering the expected future development of the Company.

The Company recorded stock-based compensation expenses of CHF 4.0 million in 2005 (2004: CHF 2.3 million) in the statement of operations. The unrecognized compensation cost as of December 31, 2005 amounts to CHF 17.9 million and is expected to be recognized over a weighted-average period of 1.7 years.

12 Shareholders' Equity

As of December 31, 2005 Basilea had 7,436,502 registered shares ("Namenaktien") issued and outstanding with a par value of CHF 1 per share. As of December 31, 2004, Basilea had 7,380,954 registered shares at CHF 1 per share issued and outstanding respectively.

In March 2004, Basilea increased its share capital by an amount of CHF 2.1 million through issuance of 2.1 million registered shares with a nominal value of CHF 1 per share through a public offering. Basilea realized net proceeds of approximately CHF 192.8 million through this capital increase and its shares were listed on the SWX Swiss Exchange.

In addition, 55,548 stock options were exercised in 2005, using conditional capital, which resulted in the issuance of 55,548 registered shares with a par value of CHF 1 per share. In 2004, 813 stock options were exercised resulting in the issuance of 813 registered shares with a par value of CHF 1 per share.

Basilea had a total approved conditional capital of CHF 2,583,639 as of December 31, 2005 for the issuance of a maximum of 2,583,639 registered shares with a nominal value of CHF 1 per share. This conditional capital contained CHF 1,943,639 (1,943,639 registered shares with a par value of CHF 1 per share) reserved for the issuance of shares under the stock option plan available to directors, executives and employees. In addition, the shareholders approved conditional capital of CHF 640,000, consisting of 640,000 registered shares at a par value of CHF 1 each, available for the exercise of option or conversion rights granted with new option or convertible bonds.

Furthermore, Basilea is authorized, through April 2007, to increase its share capital by a maximum of CHF 540,000 by issuing a maximum of 540,000 registered shares with a nominal value of CHF 1 per share.

13 Earnings/Loss per Share

In 2005 and 2004, there was no difference between basic and diluted loss per share. The weighted average number of shares outstanding and the loss per share for the years ending December 31, 2005 and 2004 are as follows:

	2005	2004
Net loss in CHF million	(49.6)	(75.5)
Weighted average number of shares outstanding, basic and diluted	7 391 863	6 903 945
Basic and diluted loss per share in CHF	(6.71)	(10.93)

The computation of the dilutive loss per share for 2005 excludes the conversion or issuance of 1,539,021 shares (2004: 1,259,629 shares) related to stock options, as the effect would have been anti-dilutive.

14 Pension Plan

The Company maintains a pension plan, which covers the employees of Basilea Pharmaceutica Ltd. The pension plan of the Company qualifies as a defined benefit plan in accordance with US GAAP. Both the Company and the participants provide monthly contributions to the pension plan, which are based on the covered salary. These contributions are credited to employees' accounts. In addition, interest is credited to the employees' accounts at the rate provided in the plan. The pension plan provides for retirement benefits as well as benefits on death or long-term disability.

The following table provides information on the pension plan as of December 31, 2005 and 2004 and for the years then ending. The measurement date for the Company's pension plan is September 30 of each year.

In CHF million	2005	2004
Service cost	1.9	2.2
Interest cost	0.8	0.7
Expected return on plan assets	(0.9)	(0.9)
Gross benefit expense	1.8	2.0
Participant contributions	(0.5)	(0.5)
Net periodic pension cost	1.3	1.5
Employer contributions	(1.5)	(1.2)
(Increase)/Decrease of prepaid pension asset	(0.2)	0.3

The reconciliation of the projected benefit obligation and the changes of the fair value of the plan assets of the Company's pension plan are shown in the following table:

In CHF million	2005	2004
Benefit obligation, beginning of period	21.7	18.8
Service cost	1.9	2.2
Interest cost	0.8	0.7
Transfers-in and -out, net	0.2	(0.4)
Actuarial loss/(gain)	(0.4)	0.4
Benefit obligation, end of period	24.2	21.7
Plan assets, beginning of period	22.8	21.9
Actual return on plan assets	1.4	(0.4)
Employer contributions	1.5	1.2
Participant contributions	0.5	0.5
Transfers-in and -out, net	0.2	(0.4)
Plan assets, end of period	26.4	22.8
Overfunding	2.2	1.1
Unrecognized net loss	1.2	2.1
Prepaid pension asset	3.4	3.2

The Company recognized a prepaid pension asset as of December 31, 2005 and 2004 in other non-current assets.

The weighted average of the key assumptions used to compute the benefit obligations were as follows:

	2005	2004
Discount rate	3%	4%
Rate of increase in compensation level	2%	2%
Expected long-term rate of return on plan assets	4%	4%

The assumption of the expected long-term rate of return on plan assets was based on long-term historical rates of returns for the different investment categories, which were adjusted, where appropriate, to reflect recent developments.

The accumulated benefit obligation (ABO) as of December 31, 2005 and 2004 amounts to CHF 23.3 million and CHF 20.7 million respectively.

The investment policy for the plan assets of the Company's pension plan on a long-term basis is to generate sufficient returns to cover the obligations of the Company's plan as they become payable. Factors considered in connection with this policy include effective risk management and liquidity needs.

The allocation of the plan assets as of the respective measurement dates in 2005 and 2004 were as follows:

	2005	2004	Target allocation
Cash and cash equivalents	28%	40%	5%
Equity securities	27%	26%	30%
Debt securities	39%	34%	60%
Other	6%	0%	5%
Total	100%	100%	100%

The expected amount of employer contributions to the Company's pension plan in 2006 is CHF 1.5 million.

The following table provides information on the estimated future undiscounted benefit payments under the Company's pension plan for each of the next five years and the aggregate for the five years thereafter:

	Amount in CHF million
2006	1.8
2007	1.7
2008	1.7
2009	1.6
2010	1.6
2011 – 2015	8.8

The amounts above include expected payments resulting from retirement, death, disability and termination during the relevant period. Potential payments transferred into the Company's pension plan resulting from hiring of employees are excluded from the amounts above. The Company does not expect that any pension benefits have to be paid by the Company's pension plan before 2012.

15 Related Party Transactions

The Company has an agreement with its shareholder, F. Hoffmann-La Roche Ltd. ("Roche"), with respect to certain of its research molecules, that allows Roche to opt-in on such compounds in exchange for milestone payments and potential future royalties. The Company is currently not pursuing those research molecules for which Roche has opt-in rights.

In December 2005, Roche decided not to exercise its option to license the Company's antifungal compound, BAL8557. In May 2004, Roche decided not to exercise its option to license the Company's antibiotic ceftobiprole.

For the year ended December 31, 2005, the Company purchased materials and services from Roche, in the amount of CHF 0.3 million (CHF 0.9 million for the year ended December 31, 2004).

The accounts receivable, accounts payable and accruals and other current liabilities do not include significant positions due to or from related parties as of December 31, 2005. The accruals and other current liabilities as of December 31, 2004 included balances to related parties in the amount of CHF 0.6 million.

16 Commitments and Contingencies

The Company entered into various purchase commitments for services and materials as well as for equipment as part of the ordinary business. These commitments are not in excess of current market prices in all material respects and reflect normal business operations.

**Report of the
Statutory Auditors**



Report of the statutory auditors to the general meeting of shareholders of
Basilea Pharmaceutica AG, Basel, Switzerland

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, statement of operations and notes) on pages 77 to 80 of Basilea Pharmaceutica AG for the year ended 31 December 2005.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the Swiss legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the Swiss profession, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of loss carried forward comply with Swiss law and the company's articles of incorporation.

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

PricewaterhouseCoopers AG

Ralph R. Reinertsen

Garrett C. Thompson

Basel, February 16, 2006

Financial Statements of Basilea Pharmaceutica Ltd.
Balance Sheets as of December 31, 2005 and 2004 (in CHF)

ASSETS	2005	2004
Current assets		
Cash and cash equivalents	28 811 260	65 963 144
Short-term investments	200 000 000	136 250 000
Accounts receivable	437 730	70 943
Other receivables	525 737	579 508
Accrued interest	949 281	474 606
Other current assets	715 487	1 496 297
Total current assets	231 439 495	204 834 498
Non-current assets		
Property, plant and equipment, net	16 759 292	18 928 131
Investment in subsidiaries, net	7 442 058	6 185 768
Capital increase costs, net	8 493 976	11 063 071
Total non-current assets	32 695 326	36 176 970
TOTAL ASSETS	264 134 821	241 011 468
LIABILITIES		
Current liabilities		
Accounts payable	723 527	1 953 444
Short-term debt	–	10 365 868
Deferred revenue	5 541 207	–
Accruals and other current liabilities	12 282 921	8 496 606
Total current liabilities	18 547 655	20 815 918
Non-current liabilities		
Deferred revenue, less current portion	68 671 971	–
Long-term debt	–	19 109
Total non-current liabilities	68 671 971	19 109
Total liabilities	87 219 626	20 835 027
SHAREHOLDERS' EQUITY		
Share capital ¹	7 436 502	7 380 954
General reserve	209 693 606	206 388 038
Free reserve	171 569 094	171 569 094
Freely disposable special reserve	47 521 269	47 521 269
Loss carried forward	(212 682 914)	(137 905 716)
Net loss	(46 622 362)	(74 777 198)
Total shareholders' equity	176 915 195	220 176 441
TOTAL LIABILITIES AND EQUITY	264 134 821	241 011 468

¹ As of December 31, 2005, 7,436,502 shares were issued and outstanding at par value of CHF 1 per share.
As of December 31, 2004, 7,380,954 shares were issued and outstanding at par value of CHF 1 per share.

These financial statements should be read in conjunction with the accompanying notes.

Statements of Operations for the years ended December 31, 2005 and 2004 (in CHF)

	2005	2004
Revenues	30 494 924	286 704
Other income	4 429 380	-
Total operating income	34 924 304	286 704
Materials, fees and grants	(47 502 390)	(45 296 847)
Personnel expenses	(19 793 340)	(17 167 574)
Depreciation	(6 169 769)	(3 951 461)
Other operating expenses	(9 333 592)	(8 839 074)
Total operating expenses	(82 799 091)	(75 254 956)
Operating loss	(47 874 787)	(74 968 252)
Interest expense	(157 437)	(442 418)
Interest income	1 779 805	776 914
Other financial expenses, net	(369 943)	(143 442)
Loss before taxes	(46 622 362)	(74 777 198)
Income taxes	-	-
Net loss	(46 622 362)	(74 777 198)

These financial statements should be read in conjunction with the accompanying notes.

Notes to the Financial Statements as of December 31, 2005

1 History

Basilea Pharmaceutica Ltd. ("Basilea") was founded on October 17, 2000.

2 Fire Insurance Value

The fire insurance value of property, plant and equipment amounted to CHF 86.6 million as of December 31, 2005 (December 31, 2004: CHF 86.0 million).

3 Liabilities due to Pension Fund

As of December 31, 2005 and 2004, no liability was outstanding due to the pension fund of Basilea.

4 Total Pledges

As of December 31, 2005, there are no assets pledged to secure liabilities.

As of December 31, 2004, Basilea pledged its land and building with a book value of CHF 14.9 million to secure a mortgage in the amount of CHF 10.0 million. This mortgage was repaid by Basilea in May 2005. In addition, a bank deposit amounting to CHF 1.3 million was pledged as of December 31, 2004 to secure lease liabilities. These lease liabilities were repaid in 2005.

5 Investments

Basilea holds 100% in BPh Investitionen Ltd., Baar, Switzerland, which is a subholding company and owns 100% of Jiangsu Innovative New Drug Research Center Co. Ltd., Haimen, China, that performs chemical supply research and development services for Basilea.

6 Share Capital, Authorized Capital and Conditional Capital

As of December 31, 2005, Basilea had 7,436,502 registered shares ("Namensaktien") issued and outstanding with a par value of CHF 1 per share. As of December 31, 2004, Basilea had 7,380,954 registered shares at CHF 1 per share issued and outstanding respectively.

In March 2004, Basilea increased its share capital by an amount of CHF 2.1 million through issuance of 2.1 million registered shares with a nominal value of CHF 1 per share through a public offering. Basilea realized net proceeds of approximately CHF 192.8 million through this capital increase and its shares were listed on the SWX Swiss Exchange.

In addition, 55,548 stock options were exercised in 2005, using conditional capital, which resulted in the issuance of 55,548 registered shares with a par value of CHF 1 per share. In 2004, 813 stock options were exercised resulting in the issuance of 813 registered shares with a par value of CHF 1 per share.

Basilea had a total approved conditional capital of CHF 2,583,639 as of December 31, 2005 for the issuance of a maximum of 2,583,639 registered shares with a nominal value of CHF 1 per share. This conditional capital contained CHF 1,943,639 (1,943,639 registered shares with a par value of CHF 1 per share) reserved for the issuance of shares under the stock option plan available to directors, executives and employees. In addition, the shareholders approved conditional capital of CHF 640,000, consisting of 640,000 registered shares at a par value of CHF 1 each, available for the exercise of option or conversion rights granted with new option or convertible bonds.

Furthermore, Basilea is authorized, through April 2007, to increase its share capital by a maximum of CHF 540,000 by issuing a maximum of 540,000 registered shares with a nominal value of CHF 1 per share.

7 Treasury shares

In 2005, Basilea did not purchase or sell any treasury shares and consequently did not hold any treasury shares as of December 31, 2005. Basilea purchased 2,500 treasury shares in 2004 at an average price of CHF 80.56 per share for the purpose of stock-based compensation. No treasury shares were held as of December 31, 2004.

8 Significant Shareholders

According to the information available to Basilea, the following shareholders held a significant percentage of shares of Basilea as of December 31, 2005:

	Percentage of outstanding shares held
F. Hoffmann-La Roche Ltd.	32.95
HBM BioVentures (Cayman) Ltd.	8.44
Chase Nominees Ltd.	5.43
Venturetech Inc.	5.42
Varuma AG	5.31

Proposal of the Board of Directors for the Appropriation of Loss Carried Forward

	2005 Proposed by the Board of Directors
Loss carried forward	(212 682 914)
Net loss	(46 622 362)
Subtotal	(259 305 276)
Release from free reserve	171 569 094
Release from freely disposable special reserve	47 521 269
Release from general reserve	40 214 913
Loss carried forward	0

Contact Information

Basilea Pharmaceutica Ltd.

Grenzacherstrasse 487
CH-4058 Basel
Switzerland
Phone +41 61 606 1111
Fax +41 61 606 1112

www.basilea.com

Investor & Public Relations

Dr. Barbara Zink
Head of Corporate Development
Phone +41 61 606 1233
Fax +41 61 606 1238
e-mail: investor_relations@basilea.com

Annual General Meeting

The Annual General Meeting of Shareholders for the financial year 2005 will take place on **March 28, 2006**, in Basel, Switzerland.

Basilea Pharmaceutica's Annual Report 2005 consists of the Business Review, the Corporate Governance section and the Financial Report. The documents are published in both English and German. In case of discrepancies the English version prevails.

Pictures on pages 22, 26 and 27:
© Friedel Ammann, Basel