



Entelos Inc.
("Entelos" or "the Company")
Preliminary Results for the year ended 31 December 2007

There will be an analyst meeting at 10:00 am in the offices of Buchanan Communications, 45 Moorfields, London, EC2Y 9AE. A conference call will be running simultaneously with the analyst meeting. Please ensure that if you wish to join the conference call you do so 5 minutes before (09:55am) the start of the briefing.

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Financial Highlights

- Recognized revenue of \$21.8 million for the full year 2007 (2006: \$21.6 million)
- Net loss of \$132,000 for the full year 2007 (2006: loss of \$754,000)
- Completed \$3.5 million follow-on placement with Pfizer Ireland Pharmaceuticals and Abingworth Management, Ltd.
- Entered into a \$6.5 million debt financing agreement with Imperium Master Fund, Ltd
- Cash, investments and accounts receivable as at 31 December 2007 totalled \$10.0 million (2006: \$9.9 million)

Operating Highlights

- Completed the Cardiovascular PhysioLab® platform
- Extended contracts with Pfizer, Organon, and Johnson & Johnson Pharmaceutical Research and Development ("J&JPRD"), and made significant progress with other customers across multiple disease areas
- Signed a two-year agreement with the US Food and Drug Administration ("FDA") to build a model of human liver physiology to better predict drug-induced liver injury ("DILI")
- Acquired a series of late stage compounds
- Created a cost-effective drug discovery and development capability through a strategic alliance with Jubilant Biosys, a premier services company based in India
- Acquired Iconix Biosciences ("Iconix"), a privately held company in an all-share transaction on 31 August 2007. Iconix's predictive toxicology capability combined with Entelos' predictive *in silico* disease models will address the pharmaceutical industry's two biggest issues around failures: safety and efficacy
- Appointed two new, independent non-executive directors to the Board

Post-Period announcements

- Entered into an agreement with UCB Pharma S.A. ("UCB Pharma") in rheumatoid arthritis
- Signed an agreement with PDL Biopharma ("PDL") to conduct *in silico* research and "virtual clinical trials" to support PDL's antibody development programs
- Appointed KBC Peel Hunt, Ltd as Nominated Advisor ("NOMAD") and broker to the Company in March 2008
- Obtained a U.S. patent that expires in 2024 for the diabetes model
- Entered into an agreement to collaborate with Conopco, Inc., d/b/a as Unilever ("Unilever") to develop a new PhysioLab platform to accelerate Unilever's product development
- The American Diabetes Association ("ADA") broadened *in silico* testing of "virtual mice" by providing its members Entelos' Type 1 Diabetes Realab platform online

Chairman and Chief Executive's Review

We are pleased to present our financial and operating results for the full year ended 31 December 2007.

The net loss for the year ended 31 December 2007 was \$132,000 (2006: net loss of \$754,000) on revenue of \$21.8 million (2006: \$21.6 million). This resulted in net loss per share (basic) of \$0.00 (2006: \$0.02). Net loss is after investment in research and development (R&D), including new applications and therapeutic development. Investment in R&D for the full year 2007 was \$6.1 million (2006: \$6.7 million).

At year end 2007 the Company had cash, investments and accounts receivable of \$10.0 million (2006: \$9.9 million). Management believes the Company will achieve its 2008 plans and stay in compliance with all of its debt covenants.

Collaborative Partners and PhysioLab® Models

Entelos partners with global pharmaceutical and biotechnology companies and provides scientific expertise and disease models to validate novel drug targets, select and develop compounds, conduct "virtual clinical trials", reprofile drugs, evaluate in-licensing candidates, and better position existing products in competitive markets. During 2007, the Company announced the following:

- Completed the Cardiovascular PhysioLab® platform, a comprehensive large-scale model designed to predict a drug's long-term clinical efficacy in managing cholesterol, atherosclerosis, and heart disease, and announced conducting cardiovascular research projects with three pharmaceutical companies.
- Extended its research agreement for two years with Organon to pursue candidate targets and biomarkers in its ongoing collaboration in rheumatoid arthritis.
- Continued its research contract with Pfizer in cardiovascular disease, Entelos' original collaborator in building the Cardiovascular PhysioLab platform.
- Entered into a Cooperative Research and Development Agreement (CRADA) with the U.S. Food and Drug Administration's Center for Drug Evaluation and Research (CDER) to develop a computer model of drug-induced liver injury (DILI). The goal is to use this platform to guide the development of clinical biomarkers and preclinical assays to identify patient types and drug combinations with an increased risk of developing liver injury.

Acquisitions, Alliances and Therapeutic Programs

Entelos can also leverage its predictive disease models to develop a portfolio of therapeutic products in areas of high unmet medical needs. The Company expanded its partnering capabilities through the following:

- Acquired a series of selective progesterone-receptor modulators from Ortho-McNeil, an affiliate of J&JPRD. The lead compound has been tested in humans, and Entelos intends to use its technology to identify optimal patient types that could benefit from treatment. Potential indications include a variety of women's health-related diseases such as endometriosis, uterine fibroids, and breast, uterine, or ovarian cancers, and Entelos will seek to partner out select programs.
- Created a broad strategic alliance with Jubilant Biosys, a premier drug discovery and development services company based in India to jointly develop and offer an integrated spectrum of services to expand each company's respective businesses with existing and future pharmaceutical and biotechnology partners. Together, Entelos and Jubilant intend to provide a spectrum of complementary and non-overlapping capabilities, ranging from predictive biosimulation, modeling, chemistry, biology, and preclinical and clinical testing to drug formulation, synthesis, manufacturing and supply to the global pharmaceutical and biotechnology industry.
- Acquired Iconix Biosciences, Inc., a privately held predictive toxicology company located in Mountain View, California, in an all-share transaction. Iconix's predictive toxicology capability, which is currently used by the FDA, combined with Entelos' predictive *in silico* disease models help to address the pharmaceutical industry's two biggest issues around drug failures: safety and

efficacy. With this acquisition, and Entelos' collaboration with the FDA, the Company has expanded its reach into safety assessment.

Board of Director Changes and Appointments

- Dr. Jonathan MacQuitty, a director of the company since March 2000 and President and Director of Abingworth's US subsidiary, Abingworth Management Inc., did not stand for re-election to the Board at the Annual General Meeting held on 23 May 2007.
- Entelos appointed two new, independent non-executive directors in February and April 2007, respectively:
 - Greg Schiffman, currently Chief Financial Officer of Seattle-based Dendreon Corporation (Nasdaq:DNDN). Mr. Schiffman brings a strong financial background from the life sciences industry and he is the chair of our Audit Committee.
 - Per Peterson, M.D., Ph.D., retired Chair of Research and Development and a former member of the Executive Committee of Johnson & Johnson (NYSE:JNJ). Dr. Peterson brings a wealth of senior executive level experience from the pharmaceutical industry.

Post-Period announcements

- Entelos announced an agreement with UCB Pharma to conduct *in silico* research in the field of rheumatoid arthritis using the Entelos® Rheumatoid Arthritis PhysioLab® platform. This platform is an innovative and predictive computer model that simulates arthritic patients and drug effects and it has already been used successfully with other pharmaceutical partners to select targets and compounds, find the best doses for patients, and support clinical trial design.
- Entelos announced an agreement with PDL Biopharma to conduct *in silico* research and "virtual clinical trials" focused on identifying primary endpoints, patient types, and optimal doses to support PDL's antibody development programs.
- Entelos appointed KBC Peel Hunt, Ltd as NOMAD and broker to the Company in March 2008.
- Entelos obtained U.S. patent #7,353,152 that expires in 2024 for the diabetes model. This patent relates to the mathematical and computer modeling of multiple biological processes underlying the Entelos® Metabolism PhysioLab® platform, which can be applied to obesity as well as diabetes research.
- Entered into an agreement to collaborate with Unilever to develop a new PhysioLab platform that will complement Unilever's internal capabilities and create a powerful integrated discovery platform to accelerate Unilever's product development.
- The American Diabetes Association broadens *in silico* testing of "virtual mice" by providing its members Entelos' Type 1 Diabetes Realab platform online.

Strategy & Outlook

Entelos has grown to become the leader in providing modeling, simulation, and disease expertise to the pharmaceutical and biotechnology industry. We intend to expand our capabilities and increase adoption within our customer base by:

- Continuing to demonstrate its impact and value for lowering the risk, time, and cost of drug discovery and development
- Assessing safety at an earlier stage of the R&D process
- Using our predictive technologies, alliances, and partnerships to discover and develop new therapeutics in a more cost-effective manner
- Salvaging therapeutic programs and initiatives through reprofiling and repositioning; that is, finding new uses and indications for existing drug programs

Our strategy thus focuses on the following key points:

- Continue to build more models and acquire complementary predictive technologies for efficacy and safety testing to generate revenue from services and technology licensing
- Create new products and offerings that allow greater customer access to our suite of predictive technologies for efficacy and safety

- Expand our offerings in safety assessment, both through our recent acquisition of Iconix Bioscience's predictive toxicology capabilities and through our efforts with the FDA
- Partner out later-stage compound assets
- Begin to grow our customer base from markets outside of pharmaceutical R&D, particularly in the health care arena where an increasingly amount of new genetic, diagnostic, and imaging data need to be combined with medical histories and other critical tests to help provide an integrative, holistic view of individual patients to dramatically improve patient choice, care, and outcomes.

We are excited about Entelos' anticipated corporate growth and look forward to continued success in the future.

Jon Saxe
Chairman of the Board
16 April 2008

James Karis
President and Chief Executive Officer

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Entelos, Inc.
Unaudited Balance Sheets

	31 December	
	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,260,079	\$ 4,702,426
Short-term investments	-	3,267,351
Accounts receivable, net of allowance of \$100,000 and \$0 at 31 December 2007 and 2006, respectively	4,693,409	1,969,539
Prepaid expenses and other current assets	464,867	238,425
Total current assets	10,418,355	10,177,741
Property and equipment, net	1,826,668	2,159,102
Intangible assets, net	9,295,131	-
Notes receivable from related parties	723,795	694,443
Other assets	375,000	375,000
Total assets	\$ 22,638,949	\$ 13,406,286
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$ 900,911	\$ 379,159
Accrued liabilities	1,806,289	527,303
Accrued compensation	2,680,665	2,133,794
Deferred revenue	5,706,813	13,770,388
Notes payable, current	-	112,446
Total current liabilities	11,094,678	16,923,090
Long-term debt	4,249,369	-
Other	37,200	-
Total liabilities	15,381,247	16,923,090
Stockholders' equity (deficit)		
Common stock, par value \$0.001, authorized 150,000,000 shares, issued and outstanding 69,109,361 and 53,265,434 shares at 31 December 2007 and 2006, respectively	69,093	53,226
Additional paid-in capital	81,354,047	70,625,226
Deferred stock-based compensation	(148,864)	(310,717)
Accumulated deficit	(74,016,574)	(73,884,579)
Total stockholders' equity (deficit)	7,257,702	(3,516,844)
Total liabilities and stockholders' equity (deficit)	\$ 22,638,949	\$ 13,406,246

Entelos, Inc.
Unaudited
Statement of Operations

	Years Ended 31 December		
	2007	2006	2005
Revenues	\$ 21,816,830	\$ 21,564,488	\$ 2,766,999
Operating costs and expenses:			
Cost of revenue	9,213,411	7,861,754	6,891,302
General and administrative	4,483,774	4,265,901	1,965,404
Research and development	6,065,278	6,673,558	5,269,771
Sales and marketing	1,777,527	2,260,110	1,964,501
Asset impairment	-	1,370,570	-
Restructuring charge	601,239	-	-
Total operating costs and expenses	22,141,229	22,431,893	16,090,978
Loss from operations	(324,399)	(867,405)	(13,323,979)
Interest income	225,778	555,772	268,726
Interest expense	(59,705)	(681,926)	(755,886)
Other income (expense), net	26,331	(154,854)	10,745
Loss before cumulative effect of change in accounting principle (Note 5)	(131,995)	(1,148,413)	(13,800,394)
Cumulative effect of change in accounting principle	-	394,549	-
Net loss	(131,995)	(753,864)	(13,800,394)
Net loss allocable to preferred stockholders	-	(34,604)	(138,888)
Net loss allocable to common stockholders	\$ (131,995)	\$ (788,468)	\$ (13,939,282)
Net loss per share - basic and diluted			
Before cumulative effect of change in accounting principle	\$ -	\$ (0.03)	\$ (1.56)
Cumulative effect of change in accounting principle	-	0.01	-
Net loss per share - basic and diluted	\$ -	\$ (0.02)	\$ (1.56)
Weighted average common shares outstanding used in calculating net loss per common share:			
Basic and diluted	58,071,254	41,427,310	8,914,997

Entelos, Inc.
Unaudited Statements of Stockholders' Equity (Deficit)

	Common Shares		Additional Paid- In Capital	Deferred Stock- Based Compensation	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount				
Balances, 31 December 2004	8,765,044	\$ 8,765	\$ 573,358	\$ (79,020)	\$ (59,156,829)	\$ (58,653,726)
Net loss					(13,800,394)	(13,800,394)
Issuance of common stock on exercise of options	459,554	460	105,445	-	-	105,905
Deferred stock-based compensation	-	-	585,158	(585,158)	-	-
Amortization of deferred stock-based compensation	-	-	-	101,581	-	101,581
Accretion on redeemable convertible preferred stock	-	-	-	-	(138,888)	(138,888)
Balances, 31 December 2005	9,224,598	9,225	1,263,961	(562,597)	(73,096,111)	(72,385,522)
Net loss	-	-	-	-	(753,864)	(753,864)
Conversion of redeemable convertible preferred stock to common stock	28,921,934	28,922	50,911,799	-	-	50,940,721
Conversion warrants for preferred stock to warrants for common stock	-	-	287,597	-	-	287,597
Issuance of common stock on exercise of options	652,964	653	149,473	-	-	150,126
Issuance of common stock upon initial public offering, net of issuance costs	13,810,173	13,810	16,622,981	-	-	16,636,791
Issuance of common stock for acquisition	655,765	656	956,761	-	-	957,417
Amortization of deferred stock-based compensation	-	-	-	146,406	-	146,406
Reversal of deferred compensation due to cancellations	-	-	(105,474)	105,474	-	-
Stock-based compensation	-	-	538,128	-	-	538,128
Accretion on redeemable convertible preferred stock	-	-	-	-	(34,604)	(34,604)
Balances, 31 December 2006	53,265,434	53,266	70,625,226	(310,717)	(73,884,579)	(3,516,804)

Entelos, Inc.
Unaudited Statements of Stockholders' Equity (Deficit)
(Continued)

	Common Shares		Additional Paid- In Capital	Deferred Stock- Based Compensation	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount				
Balances, 31 December 2006	53,265,434	53,266	70,625,226	(310,717)	(73,884,579)	(3,516,804)
Net loss	-	-	-	-	(131,995)	(131,995)
Issuance of common stock on exercise of options	265,543	248	99,538	-	-	99,786
Issuance of common stock for acquisition	9,278,771	9,279	6,065,986	-	-	6,075,265
Issuance of common stock for cash	6,299,613	6,300	3,493,700	-	-	3,500,000
Amortization of deferred based compensation	-	-	-	130,183	-	130,183
Reversal of deferred compensation due to cancellations	-	-	(31,670)	31,670	-	-
Stock-based compensation	-	-	909,718	-	-	909,718
Issuance of warrants in connection with long-term debt	-	-	191,549	-	-	191,549
Balances, 31 December 2007	69,109,361	\$ 69,093	\$ 81,354,047	\$ (148,864)	\$ (74,016,574)	\$ 7,257,702

Entelos, Inc.
Unaudited Statements of Cash Flow

	Years ended 31 December		
	2007	2006	2005
Cash flows from operating activities:			
Net loss	\$ (131,995)	\$ (753,864)	\$ (13,800,394)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,278,374	826,779	708,308
Change in fair value of warrants	—	(238,796)	—
Stock-based compensation	1,039,901	684,534	101,581
Amortization of discount on notes payable	4,938	162,850	136,196
Loss on disposal of assets	23,199	—	—
Loss due to asset impairment	—	1,370,570	—
Restructuring charge	601,239	—	—
Changes in assets and liabilities:			
Accounts receivable	(2,501,670)	532,164	3,497,583
Prepaid expenses, notes receivable and other current assets	(336,318)	464,950	(797,606)
Other assets	-	102,263	(324,754)
Accounts payable	(321,780)	(220,826)	(548,865)
Accrued liabilities	(571,601)	49,676	123,611
Accrued compensation	376,922	484,644	118,938
Deferred revenue	(8,369,046)	(11,588,987)	6,567,167
Net cash used in operating activities	<u>(8,907,837)</u>	<u>(8,124,043)</u>	<u>(4,218,235)</u>
Cash flows from investing activities:			
Purchase of short-term investments	(1,489,026)	(22,272,700)	(6,718,758)
Sales of short-term investments	4,756,377	24,109,200	3,666,341
Purchases of property and equipment	(286,760)	(1,742,182)	(833,286)
Proceeds from business acquisition	73,671	—	—
Net cash provided by (used in) investing activities	<u>3,054,262</u>	<u>94,318</u>	<u>(3,885,703)</u>

Entelos, Inc.
Unaudited Statements of Cash Flow
(Continued)

	Years ended 31 December		
	2007	2006	2005
Cash flows from financing activities:			
Proceeds from issuance of Series D redeemable convertible preferred stock, net of issuance costs	—	—	4,962,901
Proceeds from issuance of common stock	3,599,786	150,126	105,905
Proceeds from initial public offering of common stock, net	—	16,636,791	—
Change in book overdraft	—	(237,314)	237,314
Proceeds from issuance of notes payable	4,423,888	—	3,000,000
Repayment of notes payable	(1,612,446)	(4,100,457)	(1,820,562)
Net cash provided by financing activities	<u>6,411,228</u>	<u>12,449,146</u>	<u>6,485,558</u>
Net increase (decrease) in cash and cash equivalents	557,653	4,419,421	(1,618,380)
Cash and cash equivalents at beginning of year	<u>4,702,426</u>	<u>283,005</u>	<u>1,901,385</u>
Cash and cash equivalents at end of year	<u>\$ 5,260,079</u>	<u>\$ 4,702,426</u>	<u>\$ 283,005</u>
Supplemental disclosures of cash flow information:			
Interest paid	<u>\$ 42,675</u>	<u>\$ 519,135</u>	<u>\$ 439,836</u>
Supplemental disclosure of noncash investing and financing activities:			
Issuance of warrants in connection with notes payable	<u>\$ 191,549</u>	<u>—</u>	<u>—</u>
Issuance of common stock upon an acquisition	<u>\$ 6,075,265</u>	<u>\$ 957,417</u>	<u>—</u>
Issuance of redeemable preferred stock upon an acquisition	<u>—</u>	<u>—</u>	<u>\$ 500,000</u>
Deferred stock-based compensation	<u>—</u>	<u>—</u>	<u>\$ 585,158</u>
Accretion on redeemable convertible preferred stock	<u>—</u>	<u>\$ 34,604</u>	<u>\$ 138,888</u>
Reclassification of preferred stock warrant upon adoption of FSP 150-5	<u>—</u>	<u>\$ 526,392</u>	<u>—</u>

Entelos, Inc.
Notes to Financial Statements (Unaudited)

NOTE 1 - The Company and Summary of Significant Accounting Policies

The Company

Entelos, Inc (the "Company") was incorporated in the state of California on 31 July 1996. On 4 April 2006, the Company reincorporated from the State of California into the State of Delaware. On 12 April 2006, the Company completed an initial public offering on the Alternative Investment Market of the London Stock Exchange ("AIM") for the sale of 13,810,173 common shares which raised \$16.6 million of net proceeds.

Entelos is a US-based life sciences company that develops and applies next generation predictive technologies to reduce the risk, time, and cost of drug discovery and development. The Company's portfolio of proprietary computer models and toxicology reference systems—known as PhysioLab® and DrugMatrix® systems, respectively—have helped its pharmaceutical customers select novel compounds, assess drug safety, simulate clinical trials and patient populations, evaluate in-licensing candidates, and better position existing products in competitive markets. Entelos currently provides research services, technology, and scientific expertise in toxicology screening, asthma, obesity, diabetes, cardiovascular disease, rheumatoid arthritis, hematopoiesis (anemia), cholesterol metabolism, and skin sensitization. The Company's PhysioLab® systems provide a platform for creating "virtual patients" and virtual populations that can also be extended to other applications in medical education, patient support, healthcare delivery, nutritionals, and consumer products.

Going concern uncertainty

The Company has incurred significant operating losses and negative cash flows from operations since inception and will continue to be in a net loss position until sufficient revenues can be generated to offset expenses. In 2007, the Company obtained \$6.5 million in available debt financing that contains covenants pertaining to liquid assets, net working capital and quarterly operating income. If the Company does not meet the covenants it could result in the debt holder calling a portion or all of the debt. Management intends to continue to finance operations of the Company through a combination of future cash flows from operations, cost reduction measures, licensing of rights to existing compounds and if necessary, future debt/equity financings. There can be no assurance that the Company will be successful in obtaining additional financing on favorable terms, or at all. If additional funds are raised by issuing equity securities, substantial dilution to existing shareholders may result. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Risks and uncertainties

The Company is subject to all of the risks inherent in a company which operates in the intensely competitive service industry, providing a service which is relatively new and constantly evolving. These risks include, but are not limited to: the Company's ability to convince prospective strategic partners and customers that its technology is an attractive component of pharmaceutical research and development; the willingness and ability of customers to adopt new technologies; its customers' perception that the Company's technologies can help accelerate efforts and reduce costs in drug development; and the Company's ability to sell and support sufficient numbers of customer projects.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and such differences could affect the results of operations reported in future periods.

Revenue Recognition

The Company is using its patented PhysioLab® technology to derive revenue from research and development collaboration contracts. Collaboration agreements involve development of and research using dynamic computer models of human diseases, and typically require payments from customers for technology access fees, research and development funding, milestone payments (which can be either success-based or delivery-based), or a combination of these elements.

When software is not incidental to the arrangement and the services in the arrangement do not involve significant production, modification, or customization of the software, the Company recognizes revenue in accordance with

Entelos, Inc.
Notes to Financial Statements (Unaudited)
(Continued)

Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. Revenue from multiple-element arrangements is allocated to each individual element based on vendor specific objective evidence. Amounts billed but not yet recognized as revenue, and other payments received prior to recognition of revenue, are recorded as deferred revenue.

When the arrangement requires significant production, modification or customization of software, the entire arrangement is accounted in accordance with SOP 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts", as required by SOP 97-2. For arrangements for which the costs to complete a project can not be reasonably and reliably estimated, the completed contract method of accounting is used. Under the completed contract method, revenue is recognized only when a contract is completed or substantially complete.

For arrangements consisting solely of services, we recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 ("SAB 104"). Arrangements with multiple elements are accounted for in accordance with EITF 00-21, "Revenue Arrangements with Multiple Deliverables." Revenues are recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable and collectibility is reasonably assured.

Certain agreements may define specific milestones and the payments associated with each milestone. Such payments are recognized as revenue upon achievement of the milestone events, after which there are no future performance obligations to this payment. Any payments received in advance of the completion of the milestone are recorded as deferred revenue.

Reimbursements received from customers for out-of-pocket expenses are classified as revenue, with the associated costs included in cost of revenue.

Cash and cash equivalents

The Company considers all highly liquid investments purchased with an original maturity or remaining maturities of three months or less on the date of purchase to be cash equivalents. At 31 December 2007 and 2006, the Company held its cash and cash equivalents in a checking account, a money market account and investment accounts with high credit quality financial institutions.

Short-term investments

The Company classifies all short-term investments as available-for-sale in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company places its short-term investments primarily in U.S. government bonds, money market and corporate bonds. The Company held \$3,267,351 available-for-sale investments in corporate bonds at 31 December 2006. At the above date, the estimated fair value of the investments approximated their cost and the amount of gross unrealized gains and losses were not significant. There were no investments at 31 December 2007.

Realized gains and losses from the sales of short-term investments were not material for the periods presented.

Fair value of financial instruments

The carrying amounts of certain of the Company's financial instruments, including cash, cash equivalents, accounts receivable and accounts payable approximate fair value due to the relatively short maturity periods. Based on the interest rates available to the Company for debt with comparable maturities, the carrying values of the Company's notes payable and long-term debt approximate fair values.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist of cash, cash equivalents, short-term investments and accounts receivable. Cash and cash equivalents are held with a limited number of financial institutions. Deposits held with these financial institutions may exceed the amount of insurance provided on such deposits. Management believes that the financial institutions that hold the Company's investments are financially credit-worthy and, accordingly, minimal credit risk exists with respect to those investments.

Credit risk with respect to accounts receivable is concentrated due to a limited number of customers having historically accounted for a substantial portion of the Company's revenues. The Company's customers are pharmaceutical companies that are located in the United States and Europe. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The

Entelos, Inc.
Notes to Financial Statements (Unaudited)
(Continued)

Company maintains an allowance for doubtful accounts receivable based upon the expected collectibility of accounts receivable when necessary.

Concentration of credit risk with respect to net accounts receivable consists of \$1,302,768, \$1,257,500, and \$950,000 with three customers as of 31 December 2007 and \$250,000, \$200,000, \$522,039, and \$787,500 with four customers at 31 December 2006.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is generally calculated using the straight-line method over the estimated useful lives of the related assets ranging from 1 to 5 years. Leasehold improvements and assets acquired under capital leases are amortized on a straight-line basis over the term of the lease, or the useful life of the assets, whichever is shorter. Maintenance and repairs are charged to expense as incurred and improvements and betterments are capitalized. When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected in operations in the period realized.

Impairment of long-lived assets

The Company evaluates the carrying amount of its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company assesses recoverability using undiscounted cash flow attributed to that asset. If an asset is impaired, it is written down to its estimated fair market value.

Goodwill and purchased intangible assets

Identifiable finite lived intangible assets are generally comprised of service agreements and related relationships and technology and are amortized on a straight line basis over the estimated useful lives of the assets. Such lives range from 15 months to 60 months. The Company evaluates the recovery of finite lived intangible assets whenever events or changes in circumstances indicate that their current value may not be recoverable through the estimated and undiscounted future cash flows resulting from the use of the assets. If determined that the carrying value is not recoverable, impairment is measured by using the projected discounted cash flow method.

The excess of the cost of acquisition over the net amount assigned to the assets acquired and liabilities assumed is recorded as goodwill. Goodwill is not amortized but instead tested for impairment annually and whenever events or circumstances may occur that might require the need for more frequent tests.

For goodwill and intangible assets, the impairment test consists of a comparison of the fair value of the asset to its carrying amount. If the carrying amount of the asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. In valuing its goodwill and intangible assets, the Company uses the income method. Under the income approach, the fair value of a reporting unit is calculated based on the present value of estimated discounted future cash flows. The present value of estimated discounted future cash flows uses the Company's estimates of revenues driven by assumed market growth rates and estimated costs as well as appropriate discount rates.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of the Company's reporting unit with the net book value (or carrying amount), including goodwill. If the fair value of the reporting unit exceeds the carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds the fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying value of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the reporting unit goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, accordingly the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

The Company performs its annual impairment test of goodwill during the month of December based on conditions as of the end of November, in accordance with Statement of Financial Account Standards No. 142 "Goodwill and

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Notes to Financial Statements (Unaudited)
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Other Intangible Assets” (“SFAS No. 142). Impairment tests performed as of November 2007 indicated that no impairment was necessary based on the conditions at that time. During fiscal 2006, we determined that the carrying value of goodwill and net intangible assets associated with our acquisition of Discovery Innovations, Inc. exceeded their estimated fair values. The revenues as projected for the first year of operations were lower than expected. Consequently, we recorded non-cash intangible impairment charges of \$1,370,570 (see Note 6).

Software development costs

Statement of Financial Accounting Standards No. 86, “Accounting for the Costs of Computer Software to be, Sold, Leased or Otherwise Marketed,” requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company’s product development process, technological feasibility is established upon the completion of a working model. To date, costs incurred by the Company between the completion of the working model and the point at which the product is ready for general release have been insignificant. Accordingly, the Company has charged all such costs to research and development expense in the period incurred.

Research and development

Research and development costs consist primarily of compensation and related costs for personnel and consultants as well as costs related to materials, supplies, equipment depreciation and facilities allocations for scientific research and product development. All research and development costs are expensed as incurred.

Segment reporting

We organize ourselves as one segment reporting to the chief operating decision-maker. We have sales outside of the United States, which are described in Note 15. All long-lived assets are maintained in the United States.

Income Taxes

Income taxes are accounted for using an assets and liability approach, which requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company’s financial statements or tax returns. The measurement of current and deferred tax liabilities and assets are based on the provisions of enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to amounts expected to be realized.

In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes,” or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards, or SFAS, No. 109, “Accounting for Income Taxes.” FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007. Refer to Note 10 for further details of the impact of adoption.

Recent pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (“SFAS 157”) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after 15 November 2007. However, on 6 February 2008, the FASB issued FSP SFAS 157-b which defers the effective date of SFAS 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. We will adopt SFAS 157 in fiscal year 2008 except as it applies to those nonfinancial assets and nonfinancial liabilities as noted in FSP SFAS 157-b. The partial adoption of SFAS 157 will

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Notes to Financial Statements (Unaudited)
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not have a material effect on our results of operations, cash flows or financial position.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statements No. 115” (“SFAS 159”). SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the “fair value option”). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of an entity’s first fiscal year that begins after 15 November 2007. The effect, if any, of adopting SFAS 159 on our financial position and results of operations has not been finalized.

NOTE 2 – INITIAL PUBLIC OFFERING

On 12 April 2006, the Company completed its initial public offering of 13,810,173 shares of its common stock, at \$1.44 per share. Net cash proceeds of the initial public offering were approximately \$16.6 million, after deducting underwriter discounts, commissions and other offering expenses. In conjunction with the closing of the initial public offering, all of the Company’s outstanding shares of Series A, Series B, Series C, and Series D convertible preferred stock outstanding at the time of the offering were automatically converted into 28,921,934 shares of common stock.

NOTE 3 – NET LOSS PER SHARE

Basic net loss per share attributed to common shares is computed by dividing the net loss attributable to common shares for the year by the weighted average number of common shares outstanding during the year as reduced by the weighted average unvested common shares subject to repurchase by the Company. Net loss available to common stockholders is calculated using the two class method as the net loss less preferred stock dividends for the period and amounts allocated to preferred stock to reflect the rights of the preferred stock to receive dividends in preference to common stock. Diluted net loss per share is computed using the weighted average number of common and potential common shares outstanding. Potential common shares include long-term incentive awards, common stock subject to repurchase rights, and an incremental number of shares of common stock issuable upon the exercise of stock options and warrants. Potential common shares are excluded from the computation if their effect is anti-dilutive.

	Years Ended 31 December		
	2007	2006	2005
Weighted average common shares outstanding	58,106,014	41,464,695	8,919,465
Weighted average unvested common shares subject to repurchase	(34,760)	(37,385)	(4,468)
Denominator for diluted net loss per share	58,071,254	41,427,310	8,914,997

The potential shares, which are excluded from the determination of diluted net loss per share as their effect is anti-dilutive, are as follows:

	31 December		
	2007	2006	2005
Redeemable convertible preferred stock	—	—	28,380,019
Warrants to purchase common stock	1,213,379	443,332	—
Warrants to purchase redeemable convertible preferred stock	—	—	373,529
Options to purchase common stock	3,216,432	3,064,861	3,314,355
Long-term incentive plan award	7,101,313	1,987,502	—
Convertible debentures	6,382,979	—	—
Shares subject to repurchase	15,840	92,461	60,832
	17,929,943	5,588,156	32,128,735

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Notes to Financial Statements (Unaudited)
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NOTE 4 – RELATED PARTY TRANSACTIONS

At 31 December 2007, the Company held full recourse notes receivable from three employees with total balances of \$723,795. The interest rates on these notes range from 2.78 per cent to 5.26 per cent per annum. The notes mature in 2009 and 2011.

The Company has entered into various collaboration agreements with Pfizer, Inc. (whose subsidiary, Pfizer Overseas Pharmaceuticals is a shareholder of the Company) to provide consulting and research related services on drug development. Under the collaboration agreements, the Company has recognized revenues amounting to \$1,896,648, \$1,078,125 and \$937,500 for the years ended 31 December 2007, 2006 and 2005, respectively. At 31 December 2007 and 2006, the deferred revenue balance with Pfizer, Inc. was \$649,570 and \$787,500, respectively.

Mr. Saxe, a director of the Company, and Abingworth Management, a shareholder of the Company, were also a director and shareholder of Iconix BioSciences, Inc. (See Note 6 Acquisitions), respectively.

NOTE 5 – CHANGE IN ACCOUNTING POLICY

On 29 June 2005, the FASB issued Staff Position 150-5, “Issuer’s Accounting under FASB Statement No. 150 (“SFAS 150”) for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable” (“FSP 150-5”). FSP 150-5 affirms that such warrants are subject to the requirements in SFAS 150, regardless of the timing of the redemption feature or the redemption price. Therefore, under SFAS 150, the freestanding warrants that are related to the purchase of the Company’s convertible preferred stock are liabilities that should be recorded at fair value.

The Company adopted FSP 150-5 and accounted for the cumulative effect of the change in accounting principle as of 1 January 2006. In the year ended 31 December 2006, the Company recorded \$394,549 of additional income related to cumulative change in accounting principle to reflect the warrants remeasured on 1 January 2006. The Company recorded an expense of \$155,753 that is recorded in other income (expense), net to reflect the change in fair value between 1 January 2006 and 6 April 2006, the date the preferred warrants were converted to common stock warrants.

Effective 1 January 2006, the Company adopted FAS 123R using the prospective-transition method. See Note 10 for further discussion.

NOTE 6 – ACQUISITION

Iconix BioSciences, Inc.

In August 2007 the Company acquired the outstanding stock of Iconix BioSciences, Inc., a privately held predictive toxicology company located in Mountain View, CA. The initial consideration of \$6,459,702 was satisfied by the issuance of 9,278,771 shares of the Company’s common stock valued at \$6,075,265 plus acquisition related cost of \$384,437. The acquisition was accounted for using the purchase method and, accordingly, the purchase price has been allocated to the assets acquired and liabilities assumed based on estimated fair values at the date of acquisition.

The following tables summarizes, on a preliminary basis, the allocation of the purchase price of Iconix BioSciences, Inc. to the assets acquired and liabilities assumed in the acquisition and remains subject to finalization:

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Notes to Financial Statements (Unaudited)
(Continued)

Current assets.....	\$ 586,450
Fixed assets	446,668
Other assets	13,333
Existing technology.....	223,000
Customer relationships.....	939,000
Goodwill	8,368,847
Total assets acquired.....	<u>10,577,298</u>
Current liabilities.....	(2,274,925)
Deferred revenue.....	(305,471)
Notes payable.....	(1,500,000)
Other liabilities.....	(37,200)
Total liabilities assumed.....	<u>(4,117,596)</u>
Net assets acquired.....	<u>\$ 6,459,702</u>

Valuing certain components of the acquisition, including certain assets and accrued expenses required the Company to make estimates that may be adjusted in the future; consequently the purchase price allocation is considered preliminary. Final determination of these estimates could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to goodwill.

Upon the closing of the above transaction, the Company also became contingently liable for up to an additional \$25 million worth of shares of common stock in the event that certain revenue goals are met through 31 August 2008. The contingent consideration is based on the designated stock price, as defined in the purchase agreement, and will be recorded as purchase price and allocated to goodwill. In accordance with the purchase agreement 7,935,328 shares of common stock are held in escrow related to the contingent consideration.

The goodwill, existing technology, and customer relationships are recorded on the balance sheet as intangibles. None of the goodwill is deductible for tax purposes. The goodwill represents benefits of the acquisition that are additional to the fair value of the other net assets acquired. The primary reasons for the acquisition and the principal factors that contributed to the purchase price that resulted in the recognition of goodwill were as follows:

- Iconix’s predictive toxicology capability combined with Entelos’ predictive *in silico* disease models will address the pharmaceutical industry’s two biggest issues around failures: safety and efficacy.
- Iconix’s DrugMatrix system has been installed at the U.S. Food and Drug Administrative (FDA) for use by the Center for Drug Evaluation and Research (CDER) to evaluate voluntarily genomic data submissions. In addition, Iconix is a member of the Predictive Safety Testing Consortium, which is developing data and processes to support the regulatory use of new safety biomarkers.
- This acquisition of Iconix, as well as the Company’s collaboration with the FDA to develop a predictive model of drug-induced human liver injury, expands the combined companies’ reach into safety assessment.
- Iconix’s technology will also add significant new capabilities for translational medicine and for finding new uses for existing drugs and drug combinations.

Discovery Innovations, Inc.

In May 2005 the Company acquired certain assets, intellectual property and technical designs related to the software services of Discovery Innovations, Inc. The initial purchase price of \$570,440 consisted of \$500,000 of Series C convertible preferred stock and \$70,440 of acquisition related costs. The acquisition was accounted for using the purchase method. Upon closing of the transaction, the Company also became contingently liable for up to an additional 1,000,000 shares of Series C redeemable convertible preferred stock (1,349,000 common shares upon conversion) in the event certain revenue goals were met as stated in the purchase agreement. In October 2006 the Company issued an additional 655,765 shares of common stock as revenue was less than expected during the first year of operations. The consideration of \$957,417 was recorded as purchase price and allocated to goodwill. The allocation of the purchase price and additional issuance of shares was a follows:

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Notes to Financial Statements (Unaudited)
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Fixed assets	\$ 101,662
Service agreements and related relationships.....	90,000
Trademarks	20,000
Goodwill	1,316,195
	<u>\$ 1,527,857</u>

The acquired goodwill and intangibles from both acquisitions are recorded on the balance sheet as intangibles and other assets. The intangible assets are being amortized over their useful lives:

Trademarks and service agreements.....	4 years
Technology.....	5 years
Customer Relationships (Platform Alliance Customers).....	1.4 years
Customer Relationships (Service Customers).....	3 years

Goodwill was not subject to amortization. Amortization expense relating to the intangibles totaled \$235,712, \$33,958 and \$21,667, for the years ended 31 December 2007, 2006 and 2005, respectively.

As a result of our annual impairment analysis, the intangible asset related to the trademarks and service agreements and goodwill related to the acquisition of Discovery Innovation, Inc were determined to be impaired. The Company reduced the carrying value to zero and recorded a loss of \$1,370,570 due to the impairment on the Statement of Operations.

NOTE 7 – REDEEMABLE CONVERTIBLE PREFERRED STOCK

In conjunction with the closing of the initial public offering on 12 April 2006, all the Company’s outstanding shares of Series A, Series B, Series C and Series D convertible preferred stock outstanding at the time of the offering were converted into 28,921,934 shares of common stock. There was no convertible preferred stock outstanding as of 31 December 2007 and 2006.

NOTE 8 – COMMON SHARES

The Company’s Articles of Incorporation, as amended, authorize the Company to issue 150,000,000 shares of common stock. As of 31 December 2007, the Company has reserved the following shares of common stock for future issuance:

Stock options outstanding.....	3,216,432
Stock options available for future grant.....	1,014,876
Stock warrants.....	1,213,379
Stock held in escrow in connection with acquisition.....	7,935,328

NOTE 9 – STOCK OPTION PLANS

1997 Stock Option Plan

On 12 June 1997, the Company adopted the 1997 Stock Plan (the “1997 Plan”) under which 7,153,552 shares of the Company’s common stock were reserved for issuance to employees, directors and consultants. Options granted under the 1997 Plan may be incentive stock options or nonqualified stock options. Incentive stock options (“ISO”) may only be granted to employees of the Company. The nonqualified stock options (“NSO”) may be granted to Company employees, directors and consultants. Options to purchase shares of the Company’s common stock are granted at a price equal to the fair value of the stock at the date of grant, as determined by the Board of Directors. The exercise price of an ISO granted to an employee who owns stock more than 10 per cent of the voting power of all classes of stock of the Company shall not be less than 110 per cent of the fair value per share on the date of grant. Generally options terminate ten years after the date of the grant. ISO’s granted to employees who own more than ten per cent of the total stock of the Company terminate five years from the date of the grant. The options generally vest over a four year period, 25 per cent after one year and the balance ratably thereafter. The 1997 Plan has been replaced with the 2006 Equity Plan (the “2006 Plan”), cancellations of non vested options from this plan are not added back for future grants.

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The 2006 Plan

On 28 March 2006, the Company adopted the 2006 Plan under which 2,000,000 shares of the Company's common stock have been reserved for issuance to employees, directors and consultants. Options granted under the 2006 Plan may be ISO's, restricted stock awards, and NSO's to employees, directors and consultants. ISO's may be granted to current employees only. NSO's and restricted stock awards may be granted to employees, directors and consultants. ISO's may be granted with an exercise price of no less than 100% of the market value of the underlying common shares on the date of grant. NSO's and restricted stock awards may be granted with an exercise price or purchase price of no less than 85 per cent of the market value of the underlying common shares on the date of grant. No option shall be exercisable after its expiration date or have an expiration date that is more than ten years (five years in the case of a 10 per cent shareholder) after the date of grant.

The following table summarizes option activity under both stock option plans:

	Shares Available For Future Grant	Options Outstanding	Weighted Average Exercise Price
Balances at 31 December 2004	164,349	2,996,896	\$ 0.24
Additional shares reserved	1,000,000	-	
Options granted	(986,750)	986,750	0.25
Options exercised	-	(459,554)	0.23
Options canceled	209,737	(209,737)	0.25
Balances at 31 December 2005	387,336	3,314,355	0.25
Additional shares reserved	2,000,000	-	
Options granted	(630,917)	630,917	1.25
Options exercised	-	(652,964)	0.27
Options canceled	227,447	(227,447)	0.38
Balances at 31 December 2006	1,983,866	3,064,861	0.44
Options granted	(814,250)	814,250	0.79
Options exercised	-	(265,543)	0.26
Options canceled	261,995	(261,995)	0.94
Options canceled not available for future grant	(416,735)	(135,141)	-
Balances at 31 December 2007	1,014,876	3,216,432	\$ 0.50

The weighted average per share grant date fair value of stock options granted during 2007 and 2006 was \$0.38 and \$0.74, respectively, the intrinsic value of options exercised during 2007 and 2006 was \$277,930 and \$489,295, respectively and the total fair value of shares granted and vested during 2007 and 2006 was \$19,250 and \$34,407.

Option grants outstanding as of 31 December 2007 and related weighted average price and contractual life information are as follows:

Exercise price in US\$	Options Outstanding		Options Vested		
	Number Outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number vested	Weighted average exercise price
\$0.16 - \$0.20.....	67,000	1.03	\$ 0.17	67,000	\$ 0.17
\$0.25 - \$0.30.....	1,954,100	5.98	0.25	1,745,945	0.25
\$0.51 - \$0.56.....	509,000	9.80	0.54	12,873	0.56
\$1.06 - \$1.10.....	413,332	8.72	1.08	139,627	1.09
\$1.32 - \$1.61.....	273,000	8.90	1.46	47,707	1.58
	3,216,432	7.08	\$ 0.50	2,013,152	\$ 0.34

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Early Exercise of Employee Options

The Company issued common stock to employees pursuant to the early exercises of their stock options in exchange for cash. Unvested shares, comprising of 15,840 and 92,461 shares at 31 December 2007 and 2006, respectively, were subject to a repurchase right held by the Company at the original issuance price in the event the option holders' employment is terminated either voluntarily or involuntarily. For exercises of employee options, this right lapses 25 per cent on the first anniversary of the agreement and in 36 equal monthly amounts thereafter. These repurchase terms are considered to be a forfeiture provision and do not result in variable accounting. In accordance with EITF No. 00-23, "Issues related to the Accounting for Stock Compensation under APB 25", cash received from employees for exercise of unvested options are treated as a refundable deposit shown as a liability in the Company's financial statements. The amount of the liability recorded for refundable deposits at 31 December 2007 and 2006 is \$6,384 and \$26,604, respectively.

Long-Term Incentive Stock Plan

On 25 September 2007 and 5 April 2006, the Remuneration Committee of the Board of Directors granted performance stock awards pursuant to the Long Term Incentive Plan (the "LTIP"). Under the LTIP common stock will be awarded to Executive Directors and senior managers conditional upon the achievement of specific measurable performance criteria determined by the Remuneration Committee. In particular, the Company's total shareholder return ("TSR") will be measured against the TSR of companies comprised in an appropriate comparator group set by the Remuneration Committee.

The number of shares granted under the LTIP is 7,101,313 (1,987,502 in 2006 and 5,113,811 in 2007). During the year ended 31 December 2007 and 2006, compensation expense and additional paid-in capital of approximately \$813,472 and \$467,505 was recorded in relation to the LTIP. Compensation expense during the year ended 31 December 2007 was based on the fair value of the awards at date of grant. As of 31 December 2007 there was approximately \$2,483,092 of total unrecognized compensation expense related to the LTIP. Shares awarded under the LTIP vest at the end of the three year period subject to the Company achieving specified TSR targets measured as of the end of the three year period.

Stock Based Compensation

Through 31 December 2005, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and complied with the disclosure provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). Under APB No. 25, compensation cost is recognized based on the difference, if any, on the date of grant between the fair value of the Company's stock and the exercise price. SFAS No. 123 defines a "fair value" based method of accounting for an employee stock option or similar equity investment.

Effective 1 January 2006, the Company adopted FAS 123R using the prospective-transition method. Under this transition method, stock compensation cost recognized beginning 1 January 2006 includes compensation cost for all share-based payments granted on or subsequent to 1 January 2006 based on the grant-date fair value estimated in accordance with the provisions of FAS 123R and compensation expense on the remaining unvested awards under the intrinsic-value method of APB No. 25 for options granted prior to the SFAS 123R effective date.

The Company uses the Black-Scholes-Merton option-pricing model with the following assumptions to estimate the share-based compensation expense for the years ended 31 December 2007 and 2006, respectively: weighted-average risk-free interest rate of 4.34 and 4.81 per cent based on the U.S. Treasury yield for a period consistent with the expected term of the option in effect at the time of grant; no expected dividend payments; expected life of 4.60 and 4.47 years; weighted-average volatility factor of 55 and 57 per cent based on peer group analysis. Total compensation expense under SFAS 123R for the years ended 31 December 2007 and 2006 was \$909,718 and \$538,128, respectively; \$96,246 and \$70,623 was related to the 1997 and 2006 stock option plans and \$813,472 and \$467,505 was recorded in relation to the LTIP.

The Company has not been public for a significant period of time to use its own volatility. Therefore, the Company used the average volatility of similar entities. Four out of the five companies used as guideline companies are U.S. publicly traded companies that have disclosed their volatility assumptions for the year ending 31 December 2007. The Company used historical exercise data from the Company's inception for the basis of estimating the expected term.

During 2005 and 2004 options were granted to employees at exercise prices that were less than the fair market value of the common shares on the date of grant which resulted in deferred compensation of \$586,000. Amortization of

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Notes to Financial Statements (Unaudited)
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deferred stock compensation is recognized on a straight-line basis over the vesting period, reduced by cancellations of unvested options. Amortization of deferred stock compensation for 2007, 2006 and 2005 was \$130,183, \$146,406 and \$101,581, respectively.

Stock based compensation expense was recorded in the Statement of Operations as follows:

	Years Ended 31 December		
	2007	2006	2005
Cost of revenue.....	\$ 267,105	\$ 204,421	\$ -
General and administrative	483,780	133,671	18,059
Research and development.....	214,588	261,413	76,750
Sales and marketing	74,428	85,029	6,772
	<u>\$ 1,039,901</u>	<u>\$ 684,534</u>	<u>\$ 101,581</u>

As of 31 December 2007 there was \$630,676 of total unrecognized compensation expense related to non-vested stock options under APB No. 25 and SFAS No. 123R. The weighted average period over which compensation expense is expected to be recognized is 2.83 years.

NOTE 10 – INCOME TAXES

The components of deferred income tax assets and liabilities are as follows:

	Years Ended 31 December	
	2007	2006
Current deferred tax assets (liabilities):		
Accrued compensation and accrued expenses	\$ 1,919,821	\$ 1,115,067
Deferred revenue	56,288	3,101,567
Net current deferred tax assets	<u>1,976,109</u>	<u>4,216,634</u>
Noncurrent deferred tax assets:		
Federal NOL carryover	24,965,297	20,067,496
Federal research and development credit.....	1,650,724	2,407,588
Federal AMT credit.....	39,223	-
State NOL carryovers	2,603,488	2,214,642
State credit carryovers	1,106,986	1,644,298
Costs capitalized	1,600,193	814,300
Net noncurrent deferred tax assets (liabilities)	<u>31,965,911</u>	<u>27,148,324</u>
Total net deferred tax assets.....	33,942,020	31,364,958
Less: valuation reserve.....	<u>(33,942,020)</u>	<u>(31,364,958)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

The difference between the tax expense (benefit) derived by applying the Federal statutory income tax rate to the net income (loss) and the expense (benefit) recognized in the consolidated financial statements is as follows:

	Years Ended 31 December		
	2007	2006	2005
Rate Reconciliation:			
Pre-tax loss	\$ (131,995)	\$ (753,864)	\$ (13,800,394)
Federal statutory income tax rate—34%	(44,878)	(256,314)	(4,692,134)
Add (deduct) the effect of:			
State tax provision (benefit)	(7,920)	(45,232)	(604,325)
Goodwill and intangible impairment charges.....	-	570,478	-
Permanent differences and other, net.....	122,985	118,020	24,246
Federal and state tax credits.....	(349,298)	(544,354)	(628,209)
Change in valuation reserve.....	279,111	157,402	5,900,422
Total tax provision (benefit)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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Notes to Financial Statements (Unaudited)
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The Company makes certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes.

As part of the process of preparing its financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves the Company estimating its current tax exposure under the most recent tax laws and assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Company's balance sheets.

The Company assesses the likelihood that it will be able to recover its deferred tax assets. The Company considers all available evidence, both positive and negative, including historical levels of income and loss, expectations and risks associated with estimates of future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. If the Company does not consider it more likely than not that it will recover its deferred tax assets, the Company will record a valuation allowance against the deferred tax assets that it estimates will not ultimately be recoverable. As a result of the Company's analysis of all available evidence, both positive and negative, as of 31 December 2007 and 2006, the Company did not consider it was more likely than not that the Company would recover its deferred tax assets. Accordingly, a full valuation allowance was recorded for deferred tax assets. The valuation allowance increased by \$2.6 million, \$2 million, and \$5.9 million during the years ended December 31, 2007, 2006 and 2005, respectively. In accordance with SFAS 123(R), the Company has excluded from deferred tax assets tax benefits attributable to employee stock option exercises.

As of 31 December 2007, the Company had federal net operating loss carryforwards of approximately \$73.4 million and federal research and development tax credit carryforwards of approximately \$1.6 million, which expire in the years 2011 through 2027. The Company also had California net operating loss carryforwards of approximately \$40.6 million, which expire in the years 2010 through 2017, and California research and development tax credit carryforwards of approximately \$1.7 million, which do not expire. In addition, The Company also had net operating loss carryforwards from various other states of approximately \$4 million, which expire in the years 2008 through 2027.

The Internal Revenue Code of 1986, as amended and corresponding state statutes, contains provision that may limit the net operating loss and tax credit carry forwards available for use in any given period upon the occurrence of certain events, including a significant change in ownership interests. The Company recently conducted an analysis of our stock ownership to determine whether IRC Section 382 would limit the use of these tax attributes. Based on that analysis, we believe, that approximately \$53 million of NOL associated with our acquisition of IconixBioSciences, Inc. will expire unutilized. In addition, approximately \$3.9 million of Iconix federal R&D credit will expire unutilized. We believe that the balance of Iconix federal NOL (\$14.8) million and California NOL (\$2.7) million will be available to offset our combined taxable income in the future. Our analysis indicates that the balance of other tax attributes will be available, to offset our future taxable income. However, utilization of our net operating loss and research and development credit carryforwards may still be subject to substantial annual limitations due to ownership change limitations provided by the Internal Revenue Code and similar state provisions for ownership changes after 31 December 2007. Such an annual limitation could result in the expiration of the net operating loss and research and development credit carryforwards available as of 31 December 2007 before utilization.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company is subject to U.S. federal and state income tax examinations by tax authorities for tax years 1997 through 2007 due to net operating losses that are being carried forward for tax purposes.

We adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48, on 1 January 2007. As a result of the implementation of FIN 48, we did not recognize any adjustment to the liability for uncertain tax positions. As of the date of adoption, we recorded a \$1.6 million reduction to deferred tax assets, all of which was offset by a full valuation allowance and therefore did not record any adjustment to the beginning balance of retained earnings.

However, the Company has unrecognized tax benefits in connection with its acquisition of Iconix. The following is a tabular reconciliation of the total amount of unrecognized tax benefits for the year ended 31 December 2007:

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Unrecognized tax benefit at 1 January 2007.....	\$	-
Gross increases - tax position in current period.....		4,247,678
Gross decreases - tax positions in current period.....		
Unrecognized tax benefit at 31 December 2007.....		-
	<u>\$</u>	<u>4,247,678</u>

FIN 48 is not expected to have a material impact on the Company's effective tax rate in the next twelve months. Additionally, the Company does not expect any material changes in unrecognized tax benefits in the next twelve months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized for the year ended December 31, 2007.

NOTE 11 – NOTES PAYABLE

On 21 December 2007, the Company entered into a debt financing agreement with Imperium Master Fund, LTD ("Imperium") in which Imperium will provide \$6,500,000 in total cash loan proceeds. The Company used \$1,500,000 of the proceeds to repay certain debt of Iconix Biosciences, Inc. assumed in the acquisition (See Note 6) and \$5,000,000 as long-term working capital.

The financing provides the Company with \$1,500,000 under a secured bridge note and \$5,000,000 under secured convertible debentures. At the closing of the financing on 21 December 2007, the Company received a total of \$4,423,888, representing the \$4,500,000 total proceeds from the bridge note and initial debenture less certain expenses of Imperium agreed to be paid by Entelos in connection with the transaction. The expenses were recorded as a discount on the bridge note and initial debentures and will be amortized as interest expense using the effective interest method over the life of the bridge note and initial debentures.

The bridge note will mature 15 months from issuance. The principal amount of the bridge note will accrete and compound each month at the rate of 0.833 per cent per month, such that the principal amount at maturity will be \$1,698,843. The bridge note may be repaid by the Company at any time at 101 per cent of the outstanding principal amount, including accreted principal, upon 30 days notice.

In connection with the bridge note, the Company issued to Imperium a five year-term warrant to purchase up to 943,576 share of the Company's common stock at an exercise price of \$0.45 per share (Note 12).

The convertible debenture totaling \$5,000,000 is available in two separate tranches. At the closing, Imperium purchased the initial convertible debenture from the Company for an issuance purchase price of \$3,000,000 in principal amount, which debenture will have a repayment amount of \$3,314,139. On or about 9 October 2008, Imperium will purchase a \$2,000,000 principal amount convertible debenture from the Company, which will have a repayment amount of \$2,209,426. The initial principal amounts of the debentures will accrete and compound each month at the rate of 0.833 per cent per month for 12 months from their respective dates of issuance. After one year, the outstanding principal amounts will accrue interest at 8per cent per annum.

The two tranches of the convertible debenture will be identical in all respects other than the issue and amortization dates. They will amortize in 24 equal monthly payments beginning 3 years from the date of their respective issuance. If the debentures are partially converted, the monthly amortization payments will be reduced proportionately. The Company does not have the ability to call the debenture prior to its maturity.

Imperium may call the debentures upon a change in control of the Company, including a sale of 50 per cent or more of its assets or a merger in which the pre-merger Company stockholders do not hold at least 75 percent of the surviving entity, and certain other mergers of the Company, or an event of default by the Company under the debentures. In the event of such a call, the Company would be required to repay Imperium the greater of (a) 120 per cent of the unpaid principal amount of the debentures being redeemed plus all accrued and unpaid interest thereon, or (b) an amount calculated pursuant a formula based upon the Company's stock price at the time of such call. Imperium also may call the bridge note upon a change of control of the Company or an event of default; in such case the Company would be required to repay 101 per cent of the then-outstanding principal plus accrued interest and

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Notes to Financial Statements (Unaudited)
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default interest, under the bridge note.

Payment of the note and debentures is collateralized by a security interest in the assets of the Company, except certain excluded intellectual property assets.

The principal of the two tranches of the debentures will be convertible at any time at the option of Imperium into common stock of the Company at a price per share of \$0.47 per share. The conversion price was based upon 125 per cent of the average of the 20 daily volume weighted average price per share of the Company's common stock for each of the 20 business days prior to the closing of the initial debenture. The Company will not have the ability to require or force Imperium to convert the debentures. Imperium may not convert if such conversion would result in Imperium holding more than 9.9 per cent of the Company's then-outstanding share of common stock.

The debt financing agreement contains certain covenants pertaining to liquid assets, net working capital and quarterly operating income, as defined in the debt financing agreement. If the Company does not meet the liquid asset or net working capital covenants, Imperium shall have the option to notify the Company in writing demanding the Company prepay the bridge note and/or the convertible debenture then-outstanding by an aggregate amount equal to such shortfall. If the Company does not meet the quarterly operating income covenant, Imperium may call the debentures, as noted above, due to an event of default. The Company is in compliance with all covenants as of 31 December 2007.

On 29 March 2004, the Company entered into a Loan and Security Agreement (the "Agreement") with Lighthouse Capital Partners IV. The Agreement allowed for borrowings up to \$5,000,000 of working capital requirements and expires on 28 February 2008. As of 31 December 2006, the Company repaid the borrowings in full and terminated the Agreement.

In connection with this borrowing, the Company has issued warrants to purchase 200,000 shares of Series C preferred stock at \$2.50 per share (Note 14). The warrants were converted to common stock warrants upon the Company's initial public offering.

Annual maturities of long-term debt at 31 December 2007 consist of the following:

2009.....	\$ 1,698,758
2010.....	530,262
2011.....	1,846,712
2012.....	1,728,876
	<u>5,804,608</u>
Less amounts representing interest	(1,292,385)
Less discounts on Notes payable	(262,854)
	<u><u>\$ 4,249,369</u></u>

NOTE 12 – WARRANTS

In May 1999, the Company granted a warrant to purchase 173,529 shares of Series A redeemable convertible preferred stock at \$1.70 per share. The warrants are exercisable until the earlier of 17 May 2007, or one year from the effective date of the Company's initial public offering of its common shares. As of 6 April 2006, the warrants were converted from preferred warrants to warrants for 173,529 common shares. The warrants expired and were not exercised.

In conjunction with a Loan and Security Agreement entered into in March 2004, the Company issued warrants to purchase 200,000 shares of Series C redeemable convertible preferred stock at \$2.50 per share. The warrants expire in 29 March 2011. Using the Black-Scholes option pricing model with a term of seven years, volatility of 70 per cent, no dividend yield and risk-free interest rate of 3.55 per cent., the Company determined that the fair value of the warrant was \$322,000 at the date of issuance, which was recorded as a discount to the notes payable and amortized to interest expense over the loan term. The loan was repaid in full and the discount was taken into interest expense during 2006.

As of 6 April 2006 the warrants were converted from preferred warrants to common warrants. After conversion the warrants are exercisable for an aggregate of 269,803 common shares, at an exercise price of \$1.85 per common share. As of 31 December 2007, all the warrants were outstanding.

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In conjunction with the debt financing agreement dated 21 December 2007, the Company issued warrants to purchase 943,576 share of the Company's common stock at exercise price of \$0.45 per share. The warrants expire 21 December 2012. Using the Black-Scholes option pricing model with a term of five years, volatility of 55 per cent, no dividend yield and risk-free interest rate of 3.58 per cent., the Company determined that the fair value of the warrant was \$191,549 at the date of issuance, which was recorded as a discount to the notes payable and is amortized to interest expense over the loan term. As of 31 December 2007, all the warrants were outstanding.

NOTE 13 – BUSINESS SEGMENTS AND MAJOR CUSTOMERS

The Company operates in one segment, comprising of pharmaceutical R&D consulting activities to accelerate drug discovery, development and commercialization.

The Company provides services to domestic and international customers. The customer location is not always indicative of where the project is performed.

Long-lived assets outside of the United States are insignificant. The following table summarizes net revenue on a percentage basis by geographic region, based on the country in which the customer is located:

<u>Geographic Region</u>	<u>Years Ended 31 December</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
United States of America.....	78%	96%	94%
Europe.....	22%	4%	6%
Total Revenue	<u>100%</u>	<u>100%</u>	<u>100%</u>

NOTE 14 – RESTRUCTURING CHARGE

In the fourth quarter of 2007, the Company recorded \$601,239 of restructuring charges, of which \$240,505 was related to a buy-out of a purchase commitment entered into by Iconix BioSciences, Inc., and closure of the Mountain View, CA facility due to our outsourcing of the array functions to a lower cost provider. As a result, we terminated 4 employees. Substantially all of the remaining restructuring reserve balance was paid by the end of the first quarter 2008.

NOTE 15 – SUBSEQUENT EVENTS

In January 2008, the Company entered into an equipment lease line to borrow up to \$1,000,000 for equipment purchases for the period 9 January 2008 to 31 December 2008. The company has utilized \$31,815 of the line in the first quarter of 2008.