

The logo for Merrion Pharmaceuticals features the word "merrion" in a white, serif font, with a circular emblem containing a stylized, swirling design. Below "merrion" is the word "pharmaceuticals" in a smaller, white, lowercase sans-serif font.

merrion
pharmaceuticals

2010 | annual report

Merrion Pharmaceuticals plc

Annual report and financial statements

<i>Contents</i>	<i>Page</i>
Introduction to Merrion Pharmaceuticals plc	1
Directors and other information	2
Chairman's statement	3 - 4
Operating review	5 - 7
Financial review	8 - 9
Biographies of directors	10 - 11
Directors' report	12 - 18
Corporate governance statement	19 - 25
Statement of directors' responsibilities in respect of the annual report and financial statements	26
Independent auditor's report	27 - 28
Consolidated income statement	29
Consolidated statement of comprehensive income	30
Consolidated statement of financial position	31
Company statement of financial position	32
Consolidated statement of cash flows	33
Company statement of cash flows	34
Consolidated statement of changes in shareholders' equity	35
Company statement of changes in shareholders' equity	36
Notes to the financial statements	37 - 70

Merrion Pharmaceuticals plc

Introduction to Merrion Pharmaceuticals plc

Merrion Pharmaceuticals plc (“Merrion” or the “company”) (www.merrionpharma.com) is a publicly listed product development company focused on delivering innovation to the market by working on our own products and partnering to develop patented products. Established in 2003, Merrion is engaged in the development of new oral forms (tablets/capsules) of drugs that have poor absorption and are generally given by injection.

Merrion’s patented drug delivery technologies increase bioavailability, by improving absorption in the gastrointestinal tract, of drugs that are otherwise poorly absorbed. This can provide substantial benefits in patient convenience and safety, while also having the potential to enhance drug efficacy. Merrion utilises its technology to develop new oral drugs in two ways; it develops its own proprietary drugs using its GIPET® technology and partners with other pharmaceutical companies in developing oral GIPET formulations of their products.

Merrion currently has four internal product development programmes based on its GIPET technology and ten partner programmes with several pharmaceutical companies. Merrion also has two on-going license agreements with Novo Nordisk A/S to develop and commercialise oral forms of Novo Nordisk’s Insulin and GLP-1 using Merrion’s proprietary GIPET technology. In addition, the company has entered into a collaboration and option agreement with Novo Nordisk for an undisclosed compound. Merrion has oral drug delivery research collaborative programmes with Ferring Pharmaceuticals, an undisclosed ‘top ten’ pharma company, Rebel Pharmaceuticals and other non disclosed pharma companies.

Merrion is based in Dublin, in a state of the art purpose built facility which allows speed of development and reduced risk in taking ideas from conception to final Phase II formulation in our own current Good Manufacturing Practice (cGMP) facilities. In July 2010, our Citywest, Dublin facility was granted a license under the EU Clinical Directive for Investigational Medicinal Products. Merrion also has operations in Wilmington, North Carolina.

Merrion is listed on the Enterprise Securities Market of the Irish Stock Exchange (ESM) under the symbol MERR.

Merrion Pharmaceuticals plc

Directors and other information

Directors	Patrick O'Sullivan, <i>Chairman and Non-Executive Director</i> John Lynch, <i>Chief Executive Officer, Director</i> Anthony Carragher, <i>Non-Executive Director</i> Michael Donnelly, <i>Non-Executive Director</i> Michael J. McKenna, Ph.D, <i>Non-Executive Director</i> Fintan Maher, <i>Non-Executive Director</i> Harry Stratford, <i>Senior Independent Non- Executive Director</i> Peter Thornton, <i>Independent Non-Executive Director</i>
Company secretary	Jonathan O'Connell
Registered office	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland
Solicitors	Byrne Wallace Solicitors 2 Grand Canal Square Dublin 2 Ireland
Independent auditor	KPMG Chartered Accountants 1 Stokes Place St Stephen's Green Dublin 2 Ireland
Bankers	Allied Irish Banks plc 1 – 4 Lower Baggot Street Dublin 2 Ireland
Registrars	Computershare Heron House Corrig Road Sandyford Industrial Estate Dublin 18 Ireland
Registered number	443434

Merrion Pharmaceuticals plc

Chairman's Statement

Despite a difficult market, Merrion had an eventful 2010. We commenced the year with a view to expanding our own early stage pipeline, continuing our partner programmes and availing of targeted market opportunities. Achieving an Irish Medicines Board (IMB) current Good Manufacturing Practice (cGMP) license to manufacture at our Citywest facility certainly provided us with the necessary research and development (R&D) space to do this.

Partner product development programmes

The development work and the manufacture of clinical batches for our Novo Nordisk A/S projects have now been completed and this is reflected in decreased revenue when compared to the prior year. In March 2010, Novo Nordisk initiated its Phase I clinical trial with an oral GLP-1 analogue, using Merrion absorption enhancing GIPET technology. In December 2009, Novo Nordisk entered into clinical trials with oral insulin under a separate agreement with Merrion. While these are still at an early development stage, we are encouraged by the progress made in getting to the clinical phase of these programmes. Further clinical trials are ongoing in 2011.

We entered into a number of high profile transactions during the year which further strengthens our relationships with current partners and builds new ones. On the back of these, we have six additional compounds in our preclinical pipeline and the opportunity to develop the product profile of new compounds has only further validated our technology.

Merrion's internal projects

Work on expanding our early stage pipeline and developing our technology base is underway. This is an exciting time for the team as we investigate additional products which our GIPET technology could bring to the market and in doing so; make a real impact on the medical treatment of patients by improving side effect profile and enhancing drug efficacy. We hope to have some good progress news to report later in 2011.

We had some key patents issued during 2010 which were significant to the further development of Merrion's technology. In March 2010, the FDA issued a patent to cover the company's GIPET enhancer system with the bisphosphonate class of drugs. A patent covering the GIPET technology including its use with bisphosphonates has been previously granted in Europe. In May 2010, we were issued a patent specific to our Orazol tablet. These patents ensure the continued growth of our patent estate and further establish us as one of the leading companies in this space.

I can't over emphasise the effort invested in agreeing the design for a Phase III study for Orazol during the year. If approved, this drug would provide a new treatment, which could improve prognosis in combination with existing treatments for early stage breast cancer patients. We remain focused on an oral form of this drug (zoledronic acid) for the bone metastases indication; however this trial would expand Orazol's potential by allowing Orazol to be used for early treatment of breast cancer in addition to bone metastases for late stage cancer patients. Zoledronic acid has been shown to improve disease free survival in large-scale Phase III clinical studies, involving thousands of breast cancer patients.

Management and personnel

During the year Dr. Hing Kin Chan joined the Merrion team as Chief Business Officer. Dr. Chan has over 20 years successful experience in the healthcare industry. He is a terrific addition to the management team, bringing valuable experience in commercial strategies, global marketing and negotiation. This is a time of growth for Merrion as we seek to explore the strengths and diversity of our GIPET technology and Dr. Chan's commercial skills should help us do that.

Merrion Pharmaceuticals plc

Chairman's Statement (*continued*)

The performance of the Merrion team during the year, particularly in relation to setting up the new Citywest facility, achieving an Irish Medicines Board license, meeting the milestones in our partner programmes and being innovative in our internal programmes, demonstrates the strength and excellence of our people. The knowledge and experience of the management team is crucial to the continued success of Merrion. I take this opportunity to thank the entire team for their continued hard work and commitment during 2010.

Board of directors

There were no changes to the Board of Merrion during the year. Msrs Michael McKenna, Anthony Carragher and I agreed to offer ourselves for re-election and were re-elected to the Board at the Annual General Meeting in June 2010. In accordance with the Articles of Association of the company, Msrs John Lynch, Fintan Maher and Harry Stratford will be offering themselves for re-election at the forthcoming Annual General Meeting.

Corporate governance

We have set out our Corporate Governance Statement on pages 19 to 25 of these consolidated financial statements. Our Board and management are committed to maintaining the highest standards of corporate governance. We are satisfied that the appropriate level of internal control, accountability and audit and corporate social responsibility is in place throughout the company.

Outlook

During 2010, significant work was undertaken and opportunities emerged which will continue growth within Merrion. Management remains focused on licensing Orazol and the finalisation of our Phase III clinical trial design in consultation with the FDA will facilitate this. Following the advice from the FDA, the Company has started marketing the product with more clarity on the size and cost of the Phase III programme. The Company is now engaged in discussions with a number of parties regarding the licensing of Orazol. Subject to approval from the FDA, our intention is to license Orazol to a partner to complete clinical trials and file registration.

As previously mentioned, we ended the year by adding six additional partner compounds to our preclinical pipeline. On completion of these studies, partners will have the opportunity to enter into licensing agreements. Work is well underway and we are pleased with progress to date. The Novo Nordisk Phase I clinical trial manufacturing is now complete and while revenue from Novo Nordisk will decrease going forward, the new agreements give Merrion new revenue opportunities going forward.

Patrick O'Sullivan
Chairman

Merrion Pharmaceuticals plc

Operating Review

In 2010, the company made significant progress against our strategic goals. The challenge in the first half of the year was the preparation of our new Citywest facility for future Merrion operations and in July 2010, we achieved a license under the EU Clinical Directive for Investigational Medicinal Products, which allows Merrion to manufacture for clinical trials. The value of this was recognised in the second half of the year as work continued on Merrion's internal projects while still delivering a high quality service to our partners. Average headcount in Merrion grew to 40 compared to 35 in 2009.

Partner programmes

On 21 December 2010, we signed a collaboration and option agreement with Novo Nordisk, a world leader in diabetes medicine. The agreement will evaluate the ability of Merrion's patented GIPET technology to boost the oral bioavailability of an undisclosed proprietary compound. Following the feasibility studies, Novo Nordisk will have the option to enter into a further licensing agreement for Merrion's GIPET technology. The financial terms of a possible future licensing agreement have been pre-agreed. As part of the agreement Merrion has granted Novo Nordisk a warrant to acquire ordinary shares of up to €1,500,000 in Merrion at the closing share price on the date prior to the agreement (€2.73). The warrant will be exercisable for 20 business days commencing on the day following the signing of a license agreement. Merrion can also require Novo Nordisk to acquire up to €500,000 worth of shares in Merrion at the closing share price on the date prior to the agreement (€2.73) exercisable for 20 business days commencing on the day following the signing of a license agreement.

Novo Nordisk is continuing its work on oral GLP-1 analogues using our GIPET technology, with a further clinical trial expected to commence in 2011. Novo Nordisk is currently experiencing considerable market success with their injectable GLP-1, Victoza. This product is forecast to reach \$2.5-\$3 billion peak sales. An oral GLP-1 product would be expected to be a high potential product also.

In December 2009, we announced that Novo Nordisk initiated Phase I clinical trials with oral insulins using our GIPET technology. Further clinical trials are on-going in 2011.

In November 2010, Merrion entered into an oral drug delivery feasibility and option agreement with Rebel Pharmaceuticals, LLC on two undisclosed compounds. Licensing terms were agreed as part of this agreement. The project will evaluate the ability of GIPET to enhance the compounds' clinical profile and provide substantially improved products.

We are very pleased to have entered into a Feasibility and Option agreement with one of the world's top ten pharmaceutical companies to assess the ability of our GIPET technology to substantially improve the product profile of three of their patented compounds, which range in molecular weight. Following the feasibility studies, the company will have an option to enter into a licensing agreement. This project is especially important to Merrion as we are provided the opportunity to further strengthen the applicability of our platform with a wide range of compounds with varying physicochemical properties and molecular weights.

In addition Merrion is continuing its preclinical work with Ferring Pharmaceuticals and more trials are anticipated this year.

Internal projects

Merrion has four internal product development programmes based on its GIPET® technology, as follows:

1. Orazol™ for Metastatic Bone Disease is an oral Zoledronic acid tablet ready to enter Phase III development for the treatment of metastatic bone disease. Made possible using Merrion's GIPET technology, Orazol is a weekly oral tablet dosage, with greatly increased bioavailability, of the market leading I.V. bisphosphonate for bone metastases. Due to poor bioavailability, the market leading bisphosphonate is currently administered by monthly

Merrion Pharmaceuticals plc

Operating Review (*continued*)

Internal projects (continued)

intravenous infusion. The sales of Zoledronic acid as an IV infusion were over \$2.0 billion in 2010.

In Phase II trials Orazol demonstrated several benefits over the current I.V. infusion therapy including similar efficacy as measured by standard bone turnover biomarkers (CTX, u-NTx) over the study period, improved efficacy for bone pain and improved safety and tolerability profile – e.g. Acute Phase Reaction reduction. In addition to clinical advantages, Orazol offers significant benefits in patient quality of life, patient access and health economics.

Merrion has received written scientific advice from The Committee for Medicinal Products for Human Use (CHMP), agreeing the approval pathway for Orazol in Europe for the existing bone metastases indication.

Orazol™ for Breast Cancer is a novel drug product for use in adjuvant breast cancer therapy. This is a new indication, as zoledronic acid is not currently approved for this use. Adjuvant breast cancer therapy is the long term treatment of patients aimed at preventing cancer reoccurrence and progression and increasing overall survival. In the US alone, 600,000 patients annually undergo adjuvant breast cancer therapy, and most will receive treatment over many years. Extensive data from large scale clinical trials has demonstrated that the addition of zoledronic acid to standard therapy increases the rate of overall survival and reduces disease recurrence in post menopausal breast cancer patients.

Following discussions with the FDA, Merrion is currently preparing for a Phase III clinical study of Orazol for adjuvant Breast Cancer. If successful, the Phase III study will allow a new drug application for Orazol to be made under the FDA's abbreviated approval procedure section 505(b)(2) using a single Phase III study. The study will compare Orazol against placebo as an adjuvant breast cancer treatment with a primary endpoint of Disease Free Survival of patients with breast cancer. We expect that a Phase III clinical study for Orazol will commence once a license agreement with a third party has been signed.

It is anticipated that data from this trial would be sufficient to present to the EMA in order to expand the use of Orazol to earlier stage breast cancer treatment in Europe.

2. MER 102, an oral anticoagulant, has completed its preclinical testing. This programme aims to be the first oral product in the Low Molecular Weight Heparin (LMWH) class of drugs, and to offer patients an alternative to daily injections. The Company is currently looking to license this product and take it into clinical trials with a partner.
3. Almerol (MER 103) which is also an oral bisphosphonate, for the treatment of osteoporosis, has completed Phase II clinical trials. Based on the market leading drug, Fosamax®, this programme aims to provide similar absorption, with just 8% of the current dose, and a simplified dosing regimen with an improved side effect profile. The Company is currently seeking to find a partner to fund Phase III trials and take this product to market.
4. Acyline (MER 104) is an oral oncology product for the treatment of prostate cancer, which has completed Phase I clinical testing. This programme aims to be the first oral product in the area of Gonadotropin-releasing hormone (GnRH) analogues. Products in this class also have several other male/female health indications.

Merrion Pharmaceuticals plc

Operating Review *(continued)*

Patents

In March 2010, we announced the issuance of United States Patent No. 7,658,938, "Solid Oral Dosage Form Containing an Enhancer". The enhancers covered by the patent have the ability to significantly enhance oral absorption compared to standard formulations. This technology can therefore be used to enable oral (tablet) administration of compounds that are normally administered only as injectables, usually in hospital or clinic settings. Efficacy, safety and side effect profiles of drugs can be improved substantially using this delivery technology. In addition, the new products developed have potential for very significant quality of life improvements for patients and substantial economic improvements for hard pressed healthcare systems.

Subsequently, in May 2010, United States Patent No. 7,704,977, "Solid Oral Dosage Form Containing an Enhancer" covering Orazol was issued. The expiry date on this patent is 2027.

Both of these patents are part of the GIPET patent family.

Merrion's facility

In July 2010, our new facility at Citywest was granted a license by the IMB under the EU Clinical Directive for Investigational Medicinal Products. This state of the art facility was acquired by Merrion in July 2009 and it allows the Merrion team to rapidly develop in-house projects and our technology and to earn revenue from partner programmes.

Management team

In May 2010, Dr. Hing Kin Chan was appointed Chief Business Officer. Dr. Chan is responsible for the development of Merrion's commercial strategy. Dr. Chan has over 20 years experience in the healthcare industry, and joins us from DBV Technologies in Paris where he served as Chief Business Officer. Prior to this, Dr. Chan worked as Vice President of Commercial Development at ProBioGen in Berlin and as Business Development Director for Eurand in Milan. Dr. Chan's vast experience will be crucial in future deal making, portfolio reviews and in identifying new opportunities for Merrion.

Merrion Pharmaceuticals plc

Financial Review

Merrion reported a net loss of €2.5 million or €0.15 loss per basic and diluted ordinary share for the year ended 31 December 2010, compared to a net loss of €1.6 million or €0.10 loss per basic and diluted ordinary share for the prior year. The operating loss was €2.4 million for the year ended 31 December 2010 compared to an operating loss of €1.8 million for the same period last year, primarily due to the decrease in revenue.

Revenues and Cost of Sales. Revenues comprise development fees from partner agreements, milestone payments and the amortisation of up-front license payments. Total revenues were approximately €4.68 million for the year ended 31 December 2010 compared to approximately €6.34 million for the prior year ended 31 December 2009. 57% (2009: 65%) of the revenue recognised for the year was from the development work associated with the partner agreement with Novo Nordisk.

Our cost of sales consists of direct third-party expenditures, royalty expenses and allocated salaries related to our development fees recognised in the year. We had approximately €0.89 million of direct costs associated with our revenues generated for the year ended 31 December 2010 compared to approximately €1.26 million for the year ended 31 December 2009. This represents a gross margin of 81% in 2010, which is line with the previous year gross margin of 80%.

Research and Development ('R&D') Expenses. R&D expenses comprise salaries, overhead and consumables, patent costs, share-based compensation expense and clinical trial costs, reduced by R&D tax credits. R&D expenses during the year ended 31 December 2010 decreased by 6% to €4.16 million compared to €4.41 million for the prior year. The decrease was due primarily to reduced clinical trial activity. Also, R&D expenses were further reduced by the R&D tax credits of €1.12 million (2009: €0.84 million) that the company is entitled to reclaim as a rebate from payroll taxes on qualifying R&D expenses incurred in 2010. Clinical trial costs in the prior period related to the Orazol (MER 101) Phase II(b) oncology trial which was completed in 2009.

General and Administrative Expenses. General and administrative ("G&A") expenses comprise salaries, professional fees, office overhead, share-based compensation expense and other support costs. G&A expenses decreased by 20% to €1.98 million for the year ended 31 December 2010 compared to €2.48 million for the year ended 31 December 2009. This decrease was primarily due to decreased professional fees and stock compensation costs in 2010.

Net Finance Income/Expense. Net finance expense was €0.15 million for the year ended 31 December 2010 compared to net finance income of €0.18 million for the same period last year. The change year on year was as a result of a full twelve month finance expense on the mortgage and finance leases entered into during the prior year and the impact of lower interest rates on cash deposits. The company recorded a net finance expense of €0.12 million arising on a warrant and put option entered into during the year due to the signed collaboration and option and warrant agreement with Novo Nordisk in December 2010

Net Loss. Our net loss was €2.5 million for the year ended 31 December 2010 compared to a net loss of €1.6 million for the year ended 31 December 2009. The increase in our net loss was primarily due to the decrease in revenue during the year offset by decreased clinical trial costs and increased R&D tax credits.

Statement of financial position

Cash and cash equivalents as at 31 December 2010 totalled €3.31 million, a decrease of 54% as compared to €7.22 million as at 31 December 2009. The decrease in cash and cash equivalents of €3.9 million was primarily attributable to operating cash outflows of €3.1 million. The acquisition of property, plant and equipment during the year amounted to €0.38 million compared to €4.8 million in the prior year. Financing costs on secured loans and finance leases amounted to €0.14 million compared to €0.11 million in the prior year. The primary components of cash used in operating activities comprised the net loss for the period (adjusted to exclude non-cash items), an increase in working capital balances and a decrease in net interest income.

Merrion Pharmaceuticals plc

Financial Review *(continued)*

Significant statement of financial position movements year on year include an increase of 84% in non-current R&D tax credits receivable to €1.03 million, a decrease in current trade and other receivables to €1.7 million (2009: €2.47 million) and a 35% decrease in deferred income (current and non-current) to €2.91 million (2009: €4.45 million). These movements are primarily attributable to a decrease in development activity with Novo Nordisk A/S as clinical trials commence and increased R&D tax credits receivable. At 31 December 2010, loans and borrowings (current and non-current) were €2.85 million, (2009: €3.26 million). Capital repayments of €0.41 million (2009: €0.16 million) were made during the year.

The operating results are a true reflection on the work carried out during the year. The decrease in revenue compared to the prior year is a result of development work being completed and the commencement of clinical trials in our partner programmes with Novo Nordisk.

Merrion Pharmaceuticals plc

Biographies of Directors

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

Patrick O’Sullivan, Chairman and Non-Executive Director

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

John Lynch, Chief Executive Officer and Director

John Lynch has extensive pharmaceutical industry experience, with a 20 year career of achievement in many facets of the industry. In that time he has worked in senior positions in operations, business development, sales and marketing and finance. Mr. Lynch has been with Merrion since it commenced operations. Previously, Mr. Lynch was the Chief Executive Officer of JML Healthcare, providing strategic consultancy to blue chip big pharma as well as indigenous life science companies. Previous to that he had a 15 year career with Abbott Laboratories in increasingly responsible management positions, in the USA, UK and Ireland. Earlier in his career Mr. Lynch held positions with Bayer Diagnostics Limited and Ernst & Young. Mr. Lynch received a B.Comm. from University College Dublin. He is also a fellow of the Institute of Chartered Accountants in Ireland and holds marketing qualifications through the MII. Mr. Lynch also serves on the Tercentenary Board of the School of Medicine at Trinity College and the Board of the Charles Institute at University College Dublin. He is a member of Ireland’s Innovation Taskforce, established by the Irish Taoiseach in June 2009, to advise the Government on its strategy for positioning Ireland as an international innovation development hub and to assist in making the Smart Economy a reality.

Anthony Carragher, Non-Executive Director

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

Michael Donnelly, Non-Executive Director

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

Merrion Pharmaceuticals plc

Biographies of Directors *(continued)*

Michael J. McKenna, Non-Executive Director

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

Fintan Maher, Non-Executive Director

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

Harry Stratford, Senior Independent Non-Executive Director

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

Peter Thornton, Independent Non-Executive Director

Mr. Thornton has served on our board of directors since July 2006. In July 2007, Mr. Thornton joined Elan Drug Technologies and is currently Senior Vice President of Corporate development and business Operations. From September 2006 until July 2007, Mr. Thornton served as president and chief operating officer of Circ Pharma Limited, a specialty pharmaceutical product development company. From June 2004 to September 2006, Mr. Thornton served as the senior vice president and chief financial officer of Antigenics, Inc., a Nasdaq-listed biotechnology company. From 1994 to 2004, Mr. Thornton held senior management positions in operations and finance with Elan Corporation, plc, most recently as senior vice president of business operations. Earlier, Mr. Thornton worked at the international accounting firm, KPMG, in Dublin and Paris. Mr. Thornton previously served as a non-executive director of Antigenics, Inc and Cydex Pharmaceuticals, Inc. He earned a Bachelor's degree in Commerce from University College, Cork, Ireland, and is a fellow of the Institute of Chartered Accountants in Ireland.

Jonathan O'Connell Chief Financial Officer and Company Secretary

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

Merrion Pharmaceuticals plc

Directors' Report

The directors present the annual report and consolidated and company financial statements for the year ended 31 December 2010 of Merrion Pharmaceuticals plc ("the company").

Principal activities, business review and future developments

Merrion Pharmaceuticals plc and its subsidiaries ("Merrion" or "the group") is a publicly listed product development company focused on delivering innovation to the market by designing our own patented products and partnering with other pharmaceutical companies to develop patented products. The company is engaged in the development of oral dosage forms (tablets/capsules) of drugs that have poor absorption and are generally given by injection.

The financial statements present the financial results and position of the group for the year ended 31 December 2010 and the financial position of the company. The financial statements for each of the periods presented have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"), which are effective for accounting periods ending on or before 31 December 2010.

The directors are satisfied with the results and financial position of the group as at and for the year ended 31 December 2010, details of which have been presented on pages 29 and 31 of the consolidated financial statements. No dividend was paid during the year (2009: €Nil).

Key performance indicators

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

Ensuring adequate funds are in place

The group has financed its operations and internal growth principally through private placements of equity and to a lesser extent through revenues under service and license agreements with pharmaceutical companies. Members of the management team continue to investigate additional funding through public or private financings to ensure adequate resources are available for the continued growth of the group.

Efficient use of funding

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

Successful clinical trials

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

To secure development deals with leading pharmaceutical companies

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

Achieving milestone objectives

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

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Risk factors

The company has a number of business risks which are common to companies operating in the life sciences industry. Our operating performance is subject to certain risks and uncertainties including, but not limited to, the following principal items outlined below:

Development risks

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

Commercialisation risks

A key element of the business strategy is to collaborate, particularly with leading pharmaceutical companies, to develop and commercialise product candidates. In addition to development and license agreements with Novo Nordisk and a collaboration agreement with Ferring Pharmaceuticals, the company entered into feasibility and option agreements during the year with Rebel Pharmaceuticals LLC and a World Top 10 pharmaceutical company, but may not be able to negotiate acceptable arrangements with other collaborators. Moreover, such arrangements may involve sharing of profits from sales, requirements to relinquish certain of the rights to the company's products or marketing territories and impositions of other limitations on operations. These arrangements may not be scientifically or commercially successful. The termination of any of these arrangements might adversely affect Merrion's ability to develop and commercialise its product candidates.

Intellectual property risks

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

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

Financing risks

The company is a development stage enterprise. It is loss making and has negative operating cash flows. This is common for development companies in the life sciences industry. Up until December 2010, the company has financed its operations and internal stage growth principally through an initial public offering, private placements of debt and equity, bank borrowings and to a significantly lesser extent through revenues under service and license arrangements with pharmaceutical companies. As at 31 December 2010, the Company had cash and cash equivalents of €3.31 million and continues to manage and contain operating costs in order to ensure that sufficient medium term funding is available.

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Risk factors *(continued)*

Financial risk (continued)

In July 2009, the company entered into new mortgage and finance lease arrangements in connection with its acquisition of the Citywest facility. Finance costs of €0.14 million were incurred in connection with the mortgage and finance lease during the year ended 31 December 2010 (2009: €0.06 million). In addition, as floating interest rates apply in respect of the mortgage facility, the company is exposed to financial risks related to changes in interest rates.

Competition risks

Competition in the speciality pharmaceutical industry is intense, and development by other companies could render our product candidates non-competitive. We face competition from established pharmaceutical and biotechnology companies as well as from academic institutions, government agencies and private and public research institutions. Our commercial opportunity will be reduced or eliminated if our competitors develop and commercialise products that are safer, more effective, have fewer side effects or are less expensive than any products that we may develop. In addition, significant delays in the development of our product candidates could allow our competitors to bring products to market before us and impair our ability to commercialise our product candidates. Many of our competitors have significantly greater financial resources and expertise in manufacturing, preclinical testing, conducting clinical trials and obtaining regulatory approvals than we do. Established pharmaceutical companies may invest heavily to quickly discover and develop novel compounds that could make our product candidates obsolete.

There are a number of other companies developing drug delivery technologies, any one of which could be more effective or commercially successful than ours. There can be no assurance that our proprietary oral drug delivery technology, will prove to be either the most effective or the most commercially successful drug delivery technology available. Generally the drug delivery area is highly competitive with a number of companies investigating alternative approaches to improving the oral delivery of drugs, as well as other routes of administration such as transdermal or inhalation.

Financial risk management

Treasury operations are conducted within a framework of policies and guidelines approved and monitored by the board of directors. The framework allows flexibility for management to carry out board approved strategies. A discussion of the group's financial risk management objectives and policies and exposure of the group to various financial risks is included in note 19 to the consolidated financial statements.

Subsequent events

There have been no subsequent events, which would require the adjustment of or disclosure in the financial statements.

Political donations and charitable contributions

The company made no political donations during the year, (2009: €Nil), that require disclosure under the Electoral Act, 1997.

The company made no charitable contributions during the year, (2009: €Nil).

Health and safety of employees

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

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Going concern

The group is a development stage enterprise. It is loss making, which is common for development companies in the life sciences industry, and has negative operating cash flows, primarily from costs incurred in research and development programmes and administrative costs. Furthermore, the group expects to continue to incur significant operating expenses in the foreseeable future.

As at 31 December 2010, the group had cash and cash equivalents of €3.31 million and continues to manage and contain operating costs in order to ensure that sufficient medium term funding is available, in order for the group to sustain its operations and generate growth.

Management has prepared detailed strategic and financial projections for the group. A key element of the business strategy is to collaborate, particularly with leading pharmaceutical companies, to develop and commercialise product candidates and to strengthen and develop relationships with current partners.

For this reason, the continued close monitoring of the group's working capital is essential to ensure the ability of the group to continue research activities and conduct development programmes in order to gain approval and commercialise drug products.

It is clear that should the group be unable to generate additional revenues from collaboration arrangements, adjust its cost base appropriately and/or secure additional funding from debt or equity sources then this could have a material impact on the financial condition of the group.

The directors have reviewed and discussed with management its detailed financial projections for the group covering the next two years, including related costs and identified revenue opportunities. In addition, the directors have reviewed managements financing plans and options.

Based on these projections and financing options the directors are satisfied that the group can support itself for a period of at least twelve months from the date of approval of the financial statements. Consequently, the directors have adopted the going concern basis in the preparation of the financial statements.

Accounting records

The directors believe that they have complied with the requirements of Section 202 of the Companies Act, 1990 with regard to books of account by employing personnel with appropriate expertise and by providing adequate resources to the financial function. The accounting records of the company are maintained at 3200 Lake Drive, Citywest Business Campus, Dublin 24, Republic of Ireland.

Substantial shareholdings in the company

As of 28 February 2011 the following were the holders of 3% or more of the company's issued ordinary share capital as it was constituted on that date according to the register kept pursuant to Section 80 of the Companies Act, 1990:

	Number of shares	Percentage
Declan Ryan	2,475,311	14%
Goodbody Stockbroker Nominees	3,041,663	18%
European Bioscience Fund I Limited	3,305,221	19%
Growcorp Group Limited ⁽¹⁾	2,608,698	15%
Michael J. McKenna	694,198	4%
Pershing International Nominees	641,642	4%
Kernal Capital Partners	571,163	3%
Enterprise Ireland	501,083	3%
John Lynch	463,504	3%

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Substantial shareholdings in the company *(continued)*

(1) As at 31 December 2010, Mr. Michael Donnelly and Mr. Anthony Carragher were also directors of Growcorp Group Limited.

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

Directors

In accordance with the Articles of Association, one third of the directors are required to submit themselves for re-election each year. Mr. John Lynch, Mr Harry Stratford and Mr. Fintan Maher will, being eligible, offer themselves for re-election at the 2011 Annual General Meeting.

Directors and secretary and their interests

The beneficial interests of the directors and company secretary, who held office at 31 December 2010, in the ordinary share capital of the company at the dates below, were as follows:

<i>Interests in share capital</i>	Ordinary shares at par value of €0.01 each	
	At 31 December 2010	At 31 December 2009
Director		
Patrick O'Sullivan	-	-
John Lynch	463,504	463,504
Anthony Carragher	12,345	12,345
Michael Donnelly	37,037	37,037
Michael J. McKenna	694,198	694,198
Fintan Maher	18,518	18,518
Harry Stratford	-	-
Peter Thornton	17,283	17,283
Company secretary		
Jonathan O'Connell	239,952	239,952

At 31 December 2010, the market price of ordinary shares was €2.42, (2009: €3.60) and ranged from €2.42 to €4.25 during 2010, and from €3.00 to €4.85 during 2009.

Except as disclosed in this report, none of the directors or company secretary, who held office at 31 December 2010, had a beneficial interest in the share capital of the company or its subsidiaries and no such interest, the existence of which is known or could with reasonable diligence be ascertained by the relevant director, is held by any connected person.

Merrion Pharmaceuticals plc

Directors' Report (continued)

The beneficial interests of the directors and company secretary, who held office at 31 December 2010, in the share options of the company at the dates below, were as follows:

<i>Interests in share options</i>		Date of grant	Exercise price	At 1 January 2010	Granted during 2010	At 31 December 2010	Earliest exercisable date	Expiry date
Director Patrick O'Sullivan	19 May 2008	€3.58	33,000	-	33,000	18 May 2009	18 May 2015	
	11 February 2009	€4.10	10,000	-	10,000	11 February 2009	11 February 2016	
			43,000	-	43,000			
John Lynch	9 July 2008	€2.50	200,000	-	200,000	9 July 2009	9 July 2015	
	17 June 2009	€4.14	51,000	-	51,000	17 June 2009	17 June 2016	
			251,000	-	251,000			
Anthony Carragher	12 December 2007	€4.05	25,000	-	25,000	12 December 2009	12 December 2014	
	20 October 2008	€2.50	8,000	-	8,000	11 July 2009	19 October 2015	
	11 February 2009	€4.10	4,000	-	4,000	11 February 2010	11 February 2016	
			37,000	-	37,000			
Michael Donnelly	12 December 2007	€4.05	25,000	-	25,000	12 December 2009	12 December 2014	
	20 October 2008	€2.50	8,000	-	8,000	11 July 2009	19 October 2015	
	11 February 2009	€4.10	8,000	-	8,000	11 February 2010	11 February 2016	
			41,000	-	41,000			
Michael J. McKenna	7 April 2006	€0.023	126,156	-	126,156	7 April 2009	7 April 2016	
			126,156	-	126,156			
Fintan Maher	12 December 2007	€4.05	25,000	-	25,000	12 December 2009	12 December 2014	
	20 October 2008	€2.50	8,000	-	8,000	11 July 2009	19 October 2015	
	11 February 2009	€4.10	8,000	-	8,000	11 February 2010	11 February 2016	
			41,000	-	41,000			
Harry Stratford	14 January 2009	€3.35	33,000	-	33,000	10 December 2009	10 December 2015	
			33,000	-	33,000			
Peter Thornton	9 September 2007	€0.023	33,043	-	33,043	18 July 2009	5 October 2013	
			33,043	-	33,043			
Company secretary Jonathan O'Connell	20 October 2008	€2.50	130,000	-	130,000	11 July 2009	19 October 2015	
	17 June 2009	€4.14	45,000	-	45,000	17 June 2010	17 June 2016	
			175,000	-	175,000			

Merrion Pharmaceuticals plc

Directors' Report *(continued)*

Directors' remuneration

The remuneration of the directors of the company for the years ended 31 December 2010 and 2009 was as follows:

	Fees	Salary and bonus	Pension	Benefit in kind	Share - based payments	Total 2010	Total 2009
	€	€	€	€	€	€	€
Executive director							
John Lynch	-	293,326	22,000	3,200	88,158	406,684	404,649
Non executive directors							
Patrick O'Sullivan	45,000	-	-	-	16,975	61,975	73,366
Anthony Carragher ⁽¹⁾	-	-	-	-	9,524	9,524	19,360
Michael Donnelly	25,000	-	-	-	11,634	36,634	46,239
Michael J. McKenna ⁽²⁾	27,153	-	-	-	-	27,153	32,263
Fintan Maher ⁽³⁾	64,600	-	-	-	11,634	76,234	99,039
Harry Stratford	28,750	-	-	-	18,480	47,230	48,284
Peter Thornton ⁽⁴⁾	31,250	-	-	-	-	31,250	41,479
Total	221,753	293,326	22,000	3,200	156,405	696,684	764,679

- (1) Anthony Carragher is not paid a fee for his services as a director to the company.
- (2) Michael J. McKenna's fees represent consultancy fees for regulatory affairs and clinical trial strategy.
- (3) Fintan Maher's fees include fees of €39,600 that relate to investor relations consultancy services provided to the company during the year. The reduction in fees compared to the prior year reflects a reduction in services provided.
- (4) The reduction in remuneration to Peter Thornton represents a reduction in the share based payment expense compared to the prior year.

The share-based payment amounts disclosed in the above table represents the share-based compensation expense recognised in the income statement in the year ended 31 December 2010 attributable to each director.

Auditor

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

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

Corporate Governance Statement

Policies and procedures

The board of Merrion is firmly committed to adopting and maintaining the highest standards of corporate governance. As an ESM listed company, Merrion is not required to comply with the provisions of the revised Combined Code on corporate governance published by the Financial Reporting Council (“FRC”) in June 2008 and adopted by the Irish Stock Exchange, (“the Combined Code”). However, the directors have undertaken to voluntarily comply with the Combined Code, as far as practicable, having regard to the size and nature of the company. The company is currently reviewing and revising its corporate governance policy in order to comply with the new Irish Corporate Governance Annex issued by the Irish Stock Exchange in addition to the UK Corporate Governance Code issued in June 2010. The following statement describes how the provisions of the Combined Code are currently being applied.

The board of directors

Merrion is led by a strong and effective board of directors. The board of eight members comprises one executive director and seven non-executive directors. The roles of the Chairman, Mr. Patrick O’Sullivan, and Chief Executive Officer, Mr. John Lynch, are separated with a clear division of responsibility between them. The Chairman of the board is responsible for the leadership and effectiveness of the board. Our Chief Executive Officer is responsible for the operation of the business of the company while responsibility to provide constructive challenge lies with the non – executive directors. The board has an appropriate mix of skills and experience. Biographies of all directors are set out on pages 10 and 11 of this annual report.

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

The full board, which met on eight occasions during 2010, manages the overall control of the company’s affairs through a schedule of matters specifically reserved for decision at board meetings. These include approval of strategic plans, annual budgets, financial statements, authority levels for capital expenditure items, board appointments, the review of monthly and other management reports and systems of internal control.

Where the individual directors have concerns which cannot be resolved about certain actions, they are recorded in the minutes. Individual directors may seek independent professional advice in the furtherance of their duties at the company’s expense and all directors have access to the advice and services of the company secretary.

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

Merrion Pharmaceuticals plc

Corporate Governance Statement (*continued*)

Board and committee meetings

The following table shows the number of scheduled board and committee meetings held and attended by each director during the year:

	Full Board	Audit Committee	Compensation Committee	Nomination and Governance Committee
No of meetings held in 2010	8	3	2	1
John Lynch	7	-	-	-
Patrick O'Sullivan	8	-	2	1
Anthony Carragher	4	2	-	-
Michael Donnelly	6	-	2	-
Michael J. McKenna	7	-	-	-
Fintan Maher	7	3	-	-
Harry Stratford	8	-	-	1
Peter Thornton	7	3	2	-

In addition, during the year, the Chairman held eight meetings of the non executive directors, which were not attended by the executive management.

Committees of the board of directors

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

Audit Committee

The audit committee comprises three non-executive directors. The committee is chaired by Mr. Peter Thornton, who is also the audit committee financial expert. The other members are Mr. Fintan Maher and Mr. Anthony Carragher. Meetings are attended by Mr. Jonathan O'Connell, Chief Financial Officer and Mr. John Lynch, Chief Executive Officer, upon invitation by the audit committee, as appropriate. The audit committee held three meetings during 2010.

The duties and responsibilities of the committee are set down in its terms of reference, which are available on the company's website and include monitoring the appropriateness and effectiveness of internal control throughout the company, reviewing the company's accounting policies and procedures and financial reporting and reviewing the annual and interim financial statements before submission to the board. The audit committee is also responsible for monitoring the independence of the external auditor and for making recommendations to the board regarding the appointment of external auditors.

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

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

Merrion Pharmaceuticals plc

Corporate Governance Statement *(continued)*

Committees of the board of directors *(continued)*

Compensation Committee

The compensation committee is comprised of three non-executive directors. The committee is chaired by Mr. Patrick O'Sullivan. The other members are Mr. Michael Donnelly and Mr. Peter Thornton. The compensation committee held two meetings during 2010.

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

The policy of the compensation committee is designed to set remuneration levels that are appropriate for our directors and members of the executive management team, having regard to their roles and responsibilities, their individual performance and our performance as a whole. The committee sets remuneration levels in order to attract, retain and motivate individuals, whose remuneration is linked to the overall performance of the company and therefore the interests of shareholders. The committee gives due consideration to early termination provisions in contracts to avoid rewarding poor performance. There are no service contracts with directors with notice periods in excess of 6 months.

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

Details of directors' remuneration and beneficial interests in the share capital of the company are set forth in the directors' report on pages 16 to 18 of this annual report. Details of the remuneration of key management personnel is separately set forth in note 22 to the consolidated financial statements.

Nominating and Governance Committee

The nominating and governance committee is comprised of three non-executive directors. The committee is chaired by Mr. Harry Stratford. The other members are Mr. Patrick O'Sullivan and Mr. Fintan Maher. The nominating and governance committee held one meeting during 2010. The function of this committee includes overseeing the process for evaluating the board of directors and management and the consideration of appointments to the board including the evaluation of the balance of skills, knowledge and experience on the board and the articulating the capabilities, background and experience required for an appointment.

On appointment, new directors receive an induction into the group's activities and their responsibilities as directors. All the recently appointed directors have written terms and conditions. All current letters of appointment are available for inspection from the Company Secretary.

The Articles of Association of the company specify that all directors are required to submit themselves for re-election at regular intervals and at least one third of all directors must submit themselves for re-election each year. Mr. Harry Stratford, Mr John Lynch and Mr. Fintan Maher will, being eligible, offer themselves for re-election at the 2011 Annual General Meeting ("AGM").

Merrion Pharmaceuticals plc

Corporate Governance Statement *(continued)*

Independence of non-executive directors

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

The roles of the Chairman, Mr. Patrick O’Sullivan, and Chief Executive Officer, Mr. John Lynch, are separated with a clear division of responsibility between them. Non-executive directors are remunerated by way of directors’ fees and share options. Most share option grants are issued on the appointment of a director as an enticement to join the board. While the Combined Code recommends that the remuneration of non-executive directors should not include share options, the board believes that the quantum of options granted to non-executive directors is not so significant as to raise any issues concerning their independence.

At the year-end, board membership included two independent non-executive directors, namely Mr. Peter Thornton and Mr. Harry Stratford. Accordingly, pursuant to the requirements of the Combined Code, the composition of the board includes an appropriate number (at least two for small companies) of independent non-executive directors. The company has appointed Mr. Harry Stratford as its senior independent director. Mr Stratford is available to shareholders who have concerns that cannot be addressed through the Chairman, Chief Executive or Chief Financial Officer.

Share ownership and share dealings

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

Relationships with shareholders

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

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

The board also views its AGM as an ideal opportunity to communicate with both institutional and private investors alike. A business presentation is provided at the AGM, followed by a questions and answers forum which offers shareholders the opportunity to question board members. Details of proxy voting are announced in respect of each resolution considered at the AGM. The company will arrange for the notice of the 2011 AGM and related papers to be sent to shareholders at least 21 calendar days before the meeting.

Merrion Pharmaceuticals plc

Corporate Governance Statement (*continued*)

Internal control

The board has overall responsibility for the systems of internal control and for monitoring their effectiveness. These systems are designed to provide reasonable, but not absolute, assurance against material misstatement or loss. Implementation and maintenance of internal control systems is the responsibility of executive management. The board, through the audit committee, has reviewed the effectiveness of the systems of internal control for the year ended 31 December 2010 and the subsequent period to the date of approval of the financial statements.

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

Control environment

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

Identification and evaluation of business risks and controls

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

Quality and integrity of personnel

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

Project appraisal

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

Budgeting

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

Monitoring

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

Accountability and audit

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

A summary of directors' responsibilities in respect of the financial statements is given on page 26. The systems of internal control and risk management established to safeguard the company's assets is set out above. The audit committee, whose composition and functions are described above, has considered, in conjunction with the external auditor, the accounting policies adopted in the financial statements and has evaluated the internal controls that have been established within the company.

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

Merrion Pharmaceuticals plc

Corporate Governance Statement (*continued*)

Corporate social responsibility

Merrion recognises the increasing importance of corporate social responsibility and endeavours to take into account the interests of all its stakeholders when operating the business. The Company believes that having empowered and responsible employees who display sound judgement and awareness of the consequences of their decisions and actions, and who act in an ethical and responsible way, is very important to the business.

Environment

Merrion is committed to complying with environmental legislation and minimising the impact of its activities on the environment. Merrion considers that its activities have a low environmental impact. The Company is committed to minimising any adverse environmental impact of its manufacturing and laboratory facilities and complies with Irish environmental legislation.

Health and safety

Merrion has established a Health and Safety Committee to review health and safety standards within the Company on an ongoing basis. The Company has an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Committee. Merrion provides training to individuals who are responsible for health and safety.

Ethical and social policies

Merrion's principal activities are undertaken within the pharmaceutical industry which is subject to a highly regulated ethical framework with which the Company complies. In addition, Merrion seeks to conduct its activities generally in accordance with good business ethics.

Merrion does not consider it appropriate at its current stage of development to make financial donations to charitable, community or social activities, but considers that its most important contribution to the communities within which it operates is to provide high-quality employment in the pharmaceutical industry.

Employees

Merrion recognises that in an industry based on innovation, research and development, its employees are one of its biggest assets and seeks to communicate and, where appropriate, consult with them on matters affecting them as employees.

The Company does not tolerate any harassment or discrimination. Merrion practises equal treatment of all employees or potential employees irrespective of their race, creed, colour, sexual orientation, nationality, ethnic origin, religion, disability, age, gender or marital status. Merrion provides training and development appropriate to individual needs and offers remuneration packages, including pensions, private medical, permanent health and life insurance and a working environment which are designed to be both fair and competitive with larger companies within the industry. Participation in the Company's share option schemes is available to all of Merrion's employees.

Merrion has a policy of providing its employees with information about the Company through regular presentations by senior management. In addition, regular meetings are held between management and employees to allow for a free flow of information and ideas.

Family-friendly employment policies and careers

The maternity leave and maternity pay policy conforms to statutory requirements. Flexible approaches to return to work after maternity leave and part-time or non-standard hours and work patterns are considered where viable.

Merrion Pharmaceuticals plc

Corporate Governance Statement (*continued*)

Going concern

Refer to page 15 of the Directors' Report.

Compliance statement

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

- While each of the board committees is comprised of non executive directors, some of these non-executive directors are not considered independent. Accordingly, the majority of the members of the audit committee, the compensation committee and the nominating and governance committee are not independent non-executive directors as required by the Combined Code.
- The company Chairman, Mr. Patrick O'Sullivan, also chairs the compensation committee, which contravenes the guidelines under the Combined Code.
- The terms and conditions of appointment of non-executive directors are available for public inspection by contacting the company secretary. However, copies of such terms and conditions are not included on the company's website, as required by the Combined Code.
- Non-executive directors participate in the company's share option plans. The Combined Code requires that, if exceptionally, share options are granted to non-executive directors that shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. However, the company did not seek shareholder approval to make equity grants to its non-executive directors.

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

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

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

Company law requires the directors to prepare group and company financial statements for each financial year. Under that law and in accordance with the ESM Rules, the directors have prepared the group financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and have elected to prepare the company financial statements in accordance with IFRS as adopted by the EU, as applied in accordance with the Companies Acts, 1963 to 2009.

The group financial statements are required by law and IFRS as adopted by the EU, to present fairly the financial position and performance of the group. The Companies Acts, 1963 to 2009 provide in relation to such financial statements that reference in the relevant part of these Acts to financial statements giving a true and fair view are references to their achieving a fair presentation. The company financial statements are required by law to give a true and fair view of the state of affairs of the company.

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

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

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Acts, 1963 to 2009. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

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

On behalf of the board

John Lynch
Director

Peter Thornton
Director

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

We have audited the group and company financial statements of Merrion Pharmaceuticals plc for the year ended 31 December 2010, which comprise the consolidated income statement and the consolidated statement of comprehensive income, the consolidated and company statement of financial position, the consolidated and company cash flow statements, the consolidated and company statements of changes in shareholders' equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") are set out in the statement of directors' responsibilities on page 26.

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

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRS as adopted by the EU, and have been properly prepared in accordance with the provisions of the Companies Acts, 1963 to 2009 and Article 4 of the IAS Regulation. We also report to you, in our opinion, whether proper books of account have been kept by the company; whether, at the date of the statement of financial position, there exists a financial situation requiring the convening of an extraordinary general meeting of the company; and whether the information given in the directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the company statement of financial position is in agreement with the books of account.

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

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

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

(continued)

Basis of audit opinion

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

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

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of affairs of the group as at 31 December 2010, and of its loss for the year then ended;
- the company financial statements give a true and fair view, in accordance with IFRS as adopted by the EU and as applied in accordance with the provisions of the Companies Acts, 1963 to 2009, of the state of affairs of the company as at 31 December 2010; and
- the financial statements have been properly prepared in accordance with the Companies Acts, 1963 to 2009 and Article 4 of the IAS Regulation.

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

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

The net assets of the company, as stated in the company statement of financial position on page 32 are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2010 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.



Chartered Accountants
Registered Auditor,
Dublin, Ireland

11 March 2011

Merrion Pharmaceuticals plc

Consolidated Income Statement

for the year ended 31 December 2010

	<i>Note</i>	2010 €	2009 €
Revenue - continuing operations	3	4,678,081	6,335,422
Cost of sales		(889,788)	(1,256,206)
Gross profit		3,788,293	5,079,216
Research and development expenses		(4,162,223)	(4,409,583)
Administrative expenses		(1,982,410)	(2,476,594)
Loss from operating activities – continuing operations		(2,356,340)	(1,806,961)
Finance income	4	188,364	242,700
Finance expense	5	(342,500)	(64,854)
Net finance income		(154,136)	177,846
Loss before income tax	7	(2,510,476)	(1,629,115)
Income tax	8	-	-
Net loss for the year – all attributable to equity holders of the company		(2,510,476)	(1,629,115)
Basic and diluted net loss per ordinary share	9	(0.15)	(0.10)

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

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2010

	2010 €	2009 €
Net loss for the financial year	(2,510,476)	(1,629,115)
Total comprehensive income/(loss) for the year	(2,510,476)	(1,629,115)

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

Consolidated Statement of Financial Position

at 31 December 2010

	<i>Note</i>	2010 €	2009 €
Non-current assets			
Property, plant and equipment	<i>10</i>	4,729,887	5,014,598
Other receivables	<i>11</i>	1,025,268	558,097
Total non-current assets		5,755,155	5,572,695
Current assets			
Trade and other receivables	<i>12</i>	1,703,623	2,471,295
Cash and cash equivalents	<i>13</i>	3,310,387	7,218,097
Total current assets		5,014,010	9,689,392
Total assets		10,769,165	15,262,087
Non-current liabilities			
Deferred operating income		1,805,724	2,730,444
Loans and borrowings	<i>14</i>	2,356,186	2,785,538
Total non-current liabilities		4,161,910	5,515,982
Current liabilities			
Trade payables		280,850	456,504
Deferred operating income		1,106,427	1,719,140
Accrued and other payables	<i>15</i>	724,498	1,030,895
Loans and borrowings	<i>14</i>	494,449	472,425
Total current liabilities		2,606,224	3,678,964
Total liabilities		6,768,134	9,194,946
Shareholders' equity			
Share capital	<i>16</i>	171,315	171,315
Share premium		60,289,523	60,289,523
Warrant reserve	<i>17</i>	123,960	-
Reverse acquisition reserve		(25,318,907)	(25,318,907)
Share-based compensation reserve		1,603,586	1,283,180
Retained loss		(32,868,446)	(30,357,970)
Total shareholders' equity		4,001,031	6,067,141
Total liabilities and shareholders' equity		10,769,165	15,262,087

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

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

Company Statement of Financial Position

at 31 December 2010

	<i>Note</i>	2010 €	2009 €
Non-current assets			
Investment in subsidiaries	<i>23a</i>	30,600,647	30,348,489
Total non-current assets		30,600,647	30,348,489
Current assets			
Trade and other receivables	<i>23b</i>	9,920,402	9,920,279
Cash and cash equivalents	<i>23c</i>	586,269	569,325
Total current assets		10,506,671	10,489,604
Total assets		41,107,318	40,838,093
Current liabilities			
Trade and other payables	<i>23d</i>	1,960,146	1,727,843
Total current liabilities		1,960,146	1,727,843
Shareholders' equity			
Share capital	<i>23e</i>	171,315	171,315
Share premium		60,289,523	60,289,523
Warrant reserve	<i>23f</i>	123,960	-
Share-based compensation reserve		1,603,586	1,283,180
Retained loss		(23,041,212)	(22,633,768)
Total shareholders' equity		39,147,172	39,110,250
Total liabilities and shareholders' equity		41,107,318	40,838,093

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

On behalf of the board

John Lynch
Director

Peter Thornton
Director

11 March 2011

Merrion Pharmaceuticals plc

Consolidated Statement of Cash Flows

for the year ended 31 December 2010

	2010 €	2009 €
Cash flows from operating activities		
Net loss for the year	(2,510,476)	(1,629,115)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	528,540	486,701
Grant amortisation	-	(11,485)
Share based compensation expense	320,406	522,582
Net finance (income)/expense	154,136	(177,846)
	(1,507,394)	(809,163)
Change in trade and other receivables	1,138,268	(1,478,182)
Change in trade and other payables	(350,703)	6,749
Change in qualifying R&D tax credit claim	(840,979)	(837,145)
Change in deferred operating income	(1,537,433)	2,045,256
Cash used in operating activities	(3,098,241)	(1,072,485)
Interest received	132,966	277,071
Interest paid	(144,471)	(64,854)
Net cash used in operating activities	(3,109,746)	(860,268)
Cash flows from investing activities		
Purchase of property, plant and equipment	(375,937)	(4,816,081)
Net cash used in investing activities	(375,937)	(4,816,081)
Cash flows from financing activities		
Proceeds from exercise of share options by employees	-	2,274
Proceeds from issue of share capital	-	1,499,998
Proceeds from borrowings under finance lease	-	1,269,322
Proceeds from secured loan	-	2,100,000
Repayment of secured loan liabilities	(119,212)	(63,613)
Repayment of finance lease liabilities	(288,117)	(47,744)
Net cash (used in)/provided by financing activities	(407,329)	4,760,237
Net decrease in cash and cash equivalents	(3,893,012)	(916,112)
Effect of exchange rate movements on cash	(14,698)	(5,876)
Cash and cash equivalents at beginning of the year	7,218,097	8,140,085
Cash and cash equivalents at end of the year	3,310,387	7,218,097

Merrion Pharmaceuticals plc

Company Statement of Cash Flows

for the year ended 31 December 2010

	2010	2009
	€	€
Cash flows from operating activities		
Net loss for the year	(407,444)	(347,543)
Adjustments to reconcile net loss to net cash used in operating activities		
Share-based compensation expense	68,248	121,766
Net finance expense/(income)	106,878	(7,211)
	(232,318)	(232,988)
Change in trade and other payables	232,303	(717,136)
Cash used in operating activities	(15)	(950,124)
Interest received	16,959	7,211
Net cash provided by/(used in) operating activities	16,944	(942,913)
Cash flows from financing activities		
Proceeds from issue of share capital	-	1,499,998
Proceeds from share options exercise by employees	-	2,274
Net cash from financing activities	-	1,502,272
Net increase in cash and cash equivalents	16,944	559,359
Cash and cash equivalents at beginning of the year	569,325	9,966
Cash and cash equivalents at end of the year	586,269	569,325

Merrion Pharmaceuticals plc

Consolidated Statement of Changes in Shareholders' Equity

for the year ended 31 December 2010

	Share Capital Number	Share capital €	Share premium €	Warrant reserve €	Reverse acquisition reserve €	Share option reserve €	Retained losses €	Total €
Balance at 1 January 2009	16,659,157	166,592	58,791,974	-	(25,318,907)	764,853	(28,733,110)	5,671,402
<i>Comprehensive income:</i>								
Net loss for the year	-	-	-	-	-	-	(1,629,115)	(1,629,115)
Total comprehensive loss								(1,629,115)
<i>Transactions with owners of the company, recognised directly in equity</i>								
Share options exercised	7,969	79	2,195	-	-	-	-	2,274
Issue of share capital	464,383	4,644	1,495,354	-	-	-	-	1,499,998
Share based payments	-	-	-	-	-	522,582	-	522,582
Transfer of exercised and expired share based awards	-	-	-	-	-	(4,255)	4,255	-
Balance at 31 December 2009	17,131,509	171,315	60,289,523	-	(25,318,907)	1,283,180	(30,357,970)	6,067,141
<i>Comprehensive income:</i>								
Net loss for the year	-	-	-	-	-	-	(2,510,476)	(2,510,476)
Total comprehensive loss								(2,510,476)
<i>Transactions with owners of the company, recognised directly in equity</i>								
Issue of warrants	-	-	-	123,960	-	-	-	123,960
Share based payments	-	-	-	-	-	320,406	-	320,406
Balance at 31 December 2010	17,131,509	171,315	60,289,523	123,960	(25,318,907)	1,603,586	(32,868,446)	4,001,031

Merrion Pharmaceuticals plc

Company Statement of Changes in Shareholders' Equity

for the year ended 31 December 2010

	Share Capital Number	Share capital €	Share premium €	Warrant reserve €	Share option reserve €	Retained losses €	Total €
Balance at 1 January 2009	16,659,157	166,592	58,791,974	-	764,853	(22,290,480)	37,432,939
<i>Comprehensive income:</i>							
Net loss for the period	-	-	-	-	-	(347,543)	(347,543)
Total comprehensive loss							(347,543)
<i>Transactions with owners of the company, recognised directly in equity</i>							
Share options exercised	7,969	79	2,195	-	-	-	2,274
Issue of share capital	464,383	4,644	1,495,354	-	-	-	1,499,998
Share based payments	-	-	-	-	522,582	-	522,582
Transfer of exercised and expired share based awards	-	-	-	-	(4,255)	4,255	-
Balance at 31 December 2009	17,131,509	171,315	60,289,523	-	1,283,180	(22,633,768)	39,110,250
<i>Comprehensive income:</i>							
Net loss for the period	-	-	-	-	-	(407,444)	(407,444)
Total comprehensive loss							(407,444)
<i>Transactions with owners of the company, recognised directly in equity</i>							
Issue of warrants	-	-	-	123,960	-	-	123,960
Share based payments	-	-	-	-	320,406	-	320,406
Balance at 31 December 2010	17,131,509	171,315	60,289,523	123,960	1,603,586	(23,041,212)	(39,147,172)

Merrion Pharmaceuticals plc

Notes to the financial statements

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

1. Basis of preparation

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

The company and its subsidiaries (collectively referred to hereafter as “we”, “our”, “us”, “Merrion”, or “the group”) is a publicly listed product development company focused on delivering innovation to the market by developing our own patented products and partnering with other pharmaceutical companies to develop patented products.

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

Statement of compliance

As permitted by European Union (“EU”) law and in accordance with ESM Rules, the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the EU, which are effective for accounting periods ending on or before 31 December 2010. The company financial statements have also been prepared in accordance with IFRS as adopted by the EU and as applied in accordance with the Companies Acts, 1963 to 2009, which permits a company that publishes its company and group financial statements together, to take advantage of the exemption in Section 148(8) of the Companies Act, 1963 from presenting to its members both its company income statement and statement of comprehensive income and related notes which form part of the approved company financial statements.

The financial statements were authorised for issue by the board of directors on 11 March 2011.

Use of judgements and estimates

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

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

Going concern

The group is a development stage enterprise. It is loss making, which is common for development companies in the life sciences industry, and has negative operating cash flows, primarily from costs incurred in research and development programmes and administrative costs. Furthermore, the group expects to continue to incur significant operating expenses in the foreseeable future.

Merrion Pharmaceuticals plc

Notes *(continued)*

1. **Basis of preparation** *(continued)*

Going concern *(continued)*

As at 31 December 2010, the group had cash and cash equivalents of €3.31 million and continues to manage and contain operating costs in order to ensure that sufficient medium term funding is available, in order for the group to sustain its operations and generate growth.

Management has prepared detailed strategic and financial projections for the group. A key element of the business strategy is to collaborate, particularly with leading pharmaceutical companies, to develop and commercialise product candidates and to strengthen and develop relationships with current partners.

For this reason, the continued close monitoring of the group's working capital is essential to ensure the ability of the group to continue research activities and conduct development programmes in order to gain approval and commercialise drug products.

It is clear that should the group be unable to generate additional revenues from collaboration arrangements, adjust its cost base appropriately and/or secure additional funding from debt or equity sources then this could have a material impact on the financial condition of the group.

The directors have reviewed and discussed with management its detailed financial projections for the group covering the next two years, including related costs and identified revenue opportunities. In addition, the directors have reviewed managements financing plans and options.

Based on these projections and financing options the directors are satisfied that the group can support itself for a period of at least twelve months from the date of approval of the financial statements. Consequently, the directors have adopted the going concern basis in the preparation of the financial statements.

2. **Significant accounting policies**

The accounting policies applied in the preparation of the consolidated and company financial statements for the year ended 31 December 2010 are set out below. These have been applied consistently for all periods presented. There were no new standards or amendments to standards which were mandatory for the first time for the financial year beginning 1 January 2010 which had a significant impact on the consolidated financial statements.

(a) Basis of consolidation

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

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

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

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

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(b) Revenue recognition

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

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

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

(c) Cost of sales

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

(d) Research and development

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

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

(e) Employee benefits

Defined contribution plans

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

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(e) Employee benefits *(continued)*

Short term benefits

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

Share-based payment transactions

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

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

(f) Foreign currency translation

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Euro, which is the functional currency of the majority of the group's entities.

Transactions in foreign currencies are recorded at the rates of exchange prevailing at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated at the rate of exchange prevailing at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies are translated to Euro at foreign exchange rates ruling at the dates the transactions were effected. Foreign currency differences arising on retranslation are recognised in profit or loss.

(g) Finance income and expense

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

Finance expense comprises interest paid and payable on borrowings calculated using the effective interest method and loan facility fees. All borrowing costs are recognised in profit or loss. Finance charges on finance leases are expensed over the term of the lease to give a constant periodic rate of interest charge in proportion to the capital balance outstanding.

Foreign currency gains and losses are reported on a net basis.

The fair value of warrant and put options granted are measured using the Black Scholes Merton ('BSM') option pricing model and recorded as finance income or expense in the income statement.

Merrion Pharmaceuticals plc

Notes (continued)

2. Significant accounting policies (continued)

(h) Income tax

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

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

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

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

(i) Earnings/(loss) per ordinary share

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

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all potentially dilutive ordinary shares, only if not anti-dilutive, which comprise share options granted to employees and warrants issued during the year.

(j) Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Depreciation is recognised in profit or loss, so as to write off the cost, less estimated residual value, of assets on a straight line basis over the estimated useful lives of each part of an item of property, plant and equipment.

Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

	Years
Fixtures and fittings	3 – 10
Laboratory equipment	5
Buildings	50

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(j) Property, plant and equipment *(continued)*

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

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

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

Leased assets

Leases in terms of which the Group assumes substantially all the risk and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

(k) Lease obligations

Payments made under operating leases are recognised in the income statement on a straight line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(l) Impairment

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

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

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(m) Trade and other receivables

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

(n) Cash and cash equivalents

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

(o) Financial instruments

Non-derivative financial instruments

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

(p) Share capital

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

(q) Government grants

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

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

(r) Research and development tax credits

Research and development ('R&D') tax credits which are available for certain qualifying R&D expenditures incurred generally are recognised as a reduction of income tax expense. Under income tax laws in Ireland R&D tax credits may be used to offset an entity's current year income tax expense; any unused R&D tax credits may be carried forward indefinitely against future income tax liabilities; or, for periods commencing after 1 January 2009, an entity may elect to have any unused R&D tax credits paid to them by the Irish government, over a three year period.

The group has elected to receive the R&D tax credits relating to qualifying R&D expenditure incurred in the current year in the form of a refund, subject to a maximum of the payroll tax liabilities for the period in which the R&D expenditure was incurred. These refundable R&D tax credits are treated, in substance, as government grants towards R&D expenditure and are recorded as a reduction of the operating expenditure to which they relate.

Merrion Pharmaceuticals plc

Notes *(continued)*

2. Significant accounting policies *(continued)*

(r) Research and development tax credits *(continued)*

The remainder of the unused R&D tax credits that cannot be monetised in the current year is carried forward indefinitely for offset against future corporation tax liabilities. A deferred tax asset has not been recognised for this element of the R&D tax credits as the directors consider that its ultimate recovery may be uncertain.

(s) Segment reporting

The group determines and presents operating segments based on the information that internally is provided to the chief executive officer, who is the group's Chief Operating Decision Maker (CODM). The CODM assesses the performance of the business, and allocates resources, based on the consolidated loss after tax of the group for the period.

The group is managed as a single business unit engaged in the development of pharmaceutical products. Accordingly, the group operates in one reportable segment.

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

(t) New and prospective accounting standards and interpretations

We have considered all EU endorsed IFRS standards, amendments to these standards and IFRIC interpretations that have been issued, but which are not yet effective, and have not been early adopted in these financial statements, as follows:

- Amendment to IFRS 7 – Financial Instruments Disclosures – Transfers of Financial Assets, effective on 1 July 2011;
- Amendment to IFRS 1 – Severe Hyperinflation and Removal of Fixed Dates for First Time Adopters, effective on 1 July 2011;
- Amendment to IFRIC 14 – Prepayments of a minimum funding requirement, effective on 1 January 2011; and
- Amendments to IAS 24: Related Party Disclosures, effective on 1 January 2011.

The above new or revised standards and interpretations will be adopted in future financial statements, if applicable. The group does not anticipate that the adoption of these new or revised standards and interpretations will have a material impact on the group's overall results from operation and financial position.

Merrion Pharmaceuticals plc

Notes (continued)

3. Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the CODM. Our CODM has been identified as Mr. John Lynch, Chief Executive Officer.

The group is managed as a single business unit engaged in the development of pharmaceutical products. Accordingly, the group operates in one reportable segment, and our Chief Executive Officer assesses the performance of the business, and allocates resources, from this perspective, based on the consolidated loss after tax of the group for the period. The same accounting principles used for the group as a whole are applied to segment reporting.

There have been no changes to the basis of segmentation or the measurement basis for the segment profit or loss since 31 December 2009.

Segment operating performance

	2010 €	2009 €
Segment revenue – all from external customers	4,678,081	6,335,422
Segment result – net loss for the year after tax	(2,510,476)	(1,629,115)
Other segment information:		
Interest income	129,754	238,573
Interest expense	(144,471)	(64,854)
Depreciation	(528,540)	(486,701)
Share-based compensation expense	(320,406)	(522,582)
Capital expenditure	(244,589)	(4,713,693)
Segment assets and liabilities:		
Segment assets	10,769,165	15,262,087
Segment liabilities	6,768,134	9,194,946

Entity-wide disclosures

The following provides geographical information with respect to the attribution of revenue from external customers and non-current assets between the group's country of domicile and all foreign locations.

All revenue is derived from external customers and as the group operates in one reportable segment, intersegment revenue is zero. Revenues are attributed to countries on the basis of country of destination.

Revenues from one customer, Novo Nordisk A/S, represent approximately 93%, (2009: 98%) of the group's total revenues. Overall, 95% (2009: 98%) of the group's revenues are attributed to Denmark.

Novo Nordisk A/S also accounts for 81% of our current trade receivables at 31 December 2010, (2009: 98%).

Non-current assets are attributed to countries based on the location of the non-current assets.

Merrion Pharmaceuticals plc

Notes (continued)

3. Operating segments (continued)

Entity-wide disclosures

	Year ended 31 December 2010		Year ended 31 December 2009		Total €
	Country of domicile - Ireland €	Europe €	Country of domicile - Ireland €	United States €	
Revenue – all external	-	4,678,081	-	6,335,422	6,335,422
Non-current assets	5,750,668	-	5,567,390	5,305	5,572,695

Merrion Pharmaceuticals plc

Notes (continued)

4. Finance income

	2010 €	2009 €
Interest income	129,754	238,573
Net foreign exchange gain	-	4,127
Finance income on put option instrument	58,610	-
Total finance income	188,364	242,700

Interest income relates solely to interest earned from cash on deposit.

During the year ended 31 December 2010, the group recorded finance income on a put option of €58,610 (2009: €nil). Details of this put option instrument are outlined in note 17 to these consolidated financial statements.

5. Finance expense

	2010 €	2009 €
Finance expense on finance lease liabilities	79,375	35,053
Interest expense on secured loan	65,096	29,801
Finance expense on warrant instrument	182,570	-
Net foreign exchange loss	15,459	-
Total finance expense	342,500	64,854

During the year the group recorded finance expense of €144,471 on loans and finance lease liabilities (2009: €64,854). This expense related to the acquisition of a pharmaceutical freehold facility for total consideration of €3.75 million in July 2009, funded by way of a secured loan and a finance lease obligation; and to the leasing of additional equipment costing €19,322; details of which are outlined in note 14 to the consolidated financial statements.

The group recorded a finance expense of €182,570 on a warrant instrument entered into during the year (2009: €nil); the details of which are outlined in note 17 to the consolidated financial statements.

Merrion Pharmaceuticals plc

Notes (continued)

6. Payroll and related employee benefits

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

	2010 €	2009 €
Wages and salaries ⁽¹⁾	2,944,374	2,266,729
Contributions to defined contribution plans	188,179	143,816
Social welfare costs ⁽¹⁾	278,924	226,570
Equity settled share-based payment transactions ⁽²⁾	252,158	400,816
Total payroll costs	3,663,635	3,037,931

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

(2) This excludes share-based compensation expense for the year ended 31 December 2010 attributable to non-executive directors of €68,247 (2009: €121,766).

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

	2010 Number	2009 Number
Administration	7	5
Research and development	33	30
Average number of employees	40	35

At 31 December 2010, we had 34 employees (2009: 40).

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

Merrion Pharmaceuticals plc

Notes (continued)

7. Statutory and other information

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

	2010 €	2009 €
Directors' emoluments:		
Fees	221,753	238,263
Salaries and bonus	293,326	253,000
Pension contributions	22,000	22,000
Share-based compensation expense	156,405	248,752
Other emoluments and benefits in kind	3,200	2,664
Total directors' emoluments	696,684	764,679
Auditor's remuneration:		
Audit services ⁽¹⁾	58,000	58,000
Other assurance services ⁽²⁾	17,000	17,000
Taxation advisory services ⁽³⁾	-	11,400
Total auditor's remuneration	75,000	86,400
Depreciation of property, plant and equipment	528,540	486,701
Operating lease rentals	162,512	231,298
Grant amortisation	-	(11,485)

(1) Audit services include financial statement audit work performed in respect of the consolidated financial statements. €1,000 (2009: €1,000) of this relates to audit services provided to the company.

(2) Other assurance services include review of the group's half year results.

(3) Taxation advisory services include all services, except those services specifically related to the audit of financial statements, performed by the independent auditor's tax personnel; supporting other tax-related regulatory requirements; and tax compliance and reporting.

Merrion Pharmaceuticals plc

Notes (continued)

8. Income tax

No current tax expense/(benefit) arises in the current year or in the year ended 31 December 2009, due to taxable losses incurred which are available for offset against future taxable profits and losses brought forward from previous periods.

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

	2010	2009
	€	€
Loss before income tax for the year	(2,510,476)	(1,629,115)
Standard rate of corporation tax in Ireland	12.5%	12.5%
Tax on loss for the year at Irish standard rate	(313,810)	(203,639)
<i>Effect of:</i>		
Non-deductible expenses	85,316	129,949
Depreciation in excess of capital allowances	(26,232)	21,506
Interest income taxed at 25%	17,661	25,645
Unutilised losses carried forward to future periods	419,567	177,176
Non-taxable income: R&D tax credits	(182,502)	(104,643)
Tax adjustments and other timing differences	-	(45,994)
Income tax expense/(benefit) on loss for the year	-	-

At 31 December 2010, the Irish operations had net operating loss (“NOL”) carryforwards for income tax purposes that may be carried forward indefinitely available to offset against future taxable income, if any, of approximately €16,568,363, (2009: €10,899,599). At 31 December 2010, the US operations had NOL carry forwards for federal and state tax purposes of €245,109, (2009: €Nil).

The deferred tax assets of the group have not been recognised to the extent that it is considered unlikely that a benefit will be received in the future given the history of operating losses incurred. In total, the group has unrecognised deferred tax assets at 31 December 2010 of €5,379,913, (2009: €4,551,609).

Merrion Pharmaceuticals plc

Notes (continued)

9. Net loss per share

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

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

	2010 €	2009 €
Numerator (net loss)		
Basic and diluted net loss for the year attributable to ordinary shareholders	(2,510,476)	(1,629,115)
	2010 Shares	2009 Shares
Denominator (weighted average number of ordinary shares)		
Weighted average number of ordinary shares	17,131,509	16,991,734
	2010 €	2009 €
Basic and diluted loss per share		
Basic and diluted net loss per ordinary share	(0.15)	(0.10)

For the years ended 31 December 2010 and 2009, there was no difference in the weighted average number of ordinary shares used for the basic and diluted net loss per ordinary share computation, as the effect of all potentially dilutive shares are anti-dilutive due to the existence of net losses from inception of the company. At 31 December 2010, there were share options and warrants outstanding of 1,699,555 (2009: 1,345,487) which could potentially have a dilutive impact in the future, but which were anti-dilutive in 2010 and 2009.

Merrion Pharmaceuticals plc

Notes (continued)

10. Property, plant and equipment

	Land & buildings €	Fixtures and fittings €	Laboratory equipment €	Total €
Cost				
Balance at 1 January 2009	-	150,785	2,016,642	2,167,427
Additions	3,375,138	62,375	1,276,180	4,713,693
Balance at 31 December 2009	3,375,138	213,160	3,292,822	6,881,120
Accumulated depreciation				
Balance at 1 January 2009	-	79,285	1,300,536	1,379,821
Charge for the year	19,273	34,643	432,785	486,701
Balance at 31 December 2009	19,273	113,928	1,733,321	1,866,522
Net book value				
At 31 December 2009	3,355,865	99,232	1,559,501	5,014,598
Cost				
Balance at 1 January 2010	3,375,138	213,160	3,292,822	6,881,120
Additions	106,924	31,837	105,828	244,589
Disposals	-	(53,925)	-	(53,925)
Balance at 31 December 2010	3,482,062	191,072	3,398,650	7,071,784
Accumulated depreciation				
Balance at 1 January 2010	19,273	113,928	1,733,321	1,866,522
Charge for the year	42,367	51,915	434,258	528,540
Disposals	-	(53,165)	-	(53,165)
Balance at 31 December 2010	61,640	112,678	2,167,579	2,341,897
Net book value				
At 31 December 2010	3,420,422	78,394	1,231,071	4,729,887

At 31 December 2010, the net book value of land and buildings held under secured loan amounted to €2,062,200 (2009: €2,087,400), which is net of €37,800 (2009: €12,600) accumulated depreciation.

Included within land and buildings is €1,300,000 in land, which is not depreciated.

The net book value of equipment held under finance leasing arrangements at 31 December 2010 amounted to €51,431 (2009: €1,105,279), which is net of €417,813 (2009: €163,965) accumulated depreciation. Depreciation expense for the year amounted to €253,848 (2009: €161,475).

During the year, fixtures and fittings with a cost of €3,925 (2009: €nil) were disposed of as part of the relocation to the Citywest facility, resulting in a loss on disposal of €6,231 (2009: €nil), recognised within R&D expenses.

Merrion Pharmaceuticals plc

Notes (continued)

11. Research and development tax credits

	2010 €	2009 €
Balance at beginning of year	837,145	-
R&D tax credit claimed in the year	1,117,237	837,145
R&D tax credit received during the year	(276,258)	-
Balance at end of year	1,678,124	837,145
Categorised as follows:		
Non-current assets: other receivables	1,025,268	558,097
Current assets: trade and other receivables (note 12)	652,856	279,048
Total	1,678,124	837,145

The qualifying R&D tax credits are treated, in substance, as government grants towards R&D expenditure and as such, the group recognised a reduction in R&D expenditure in the consolidated income statement for the claims made to receive €1,117,237 in respect of fiscal 2010 (2009: €837,145) in the form of a cash payback, to be paid by the Irish government over a three year period.

The remainder of the R&D tax credits in respect of fiscal 2010 of €46,595 (2009: €75,043) cannot be monetised, but can be carried forward indefinitely for offset against future corporation tax liabilities. A deferred tax asset has not been recognised for this element of the R&D tax credits as the directors consider that its ultimate recovery is uncertain at this point in time.

12. Trade and other receivables

	2010 €	2009 €
Trade receivables	936,764	1,926,142
Prepayments	75,580	226,442
Other receivables	32,265	15,824
Corporation tax receivable	6,158	23,839
Research and development tax credits receivable (note 11)	652,856	279,048
Total trade and other receivables	1,703,623	2,471,295

All amounts fall due within one year. At 31 December 2010 and 2009 €Nil of our trade receivables balance was past due but not impaired. Our provision for doubtful debts was €Nil at both 31 December 2010 and 2009.

The group's exposure to credit and currency risks is disclosed in note 19 to these consolidated financial statements.

Merrion Pharmaceuticals plc

Notes (continued)

13. Cash and cash equivalents

	2010 €	2009 €
Bank balances	184,342	338,520
Call deposits	3,126,045	6,879,577
Total cash and cash equivalents	3,310,387	7,218,097

The group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 19 to these consolidated financial statements.

14. Loans and borrowings

	2010 €	2009 €
Non-current		
Secured bank loan	1,748,736	1,867,947
Finance lease liabilities	607,450	917,591
Total	2,356,186	2,785,538
Current		
Secured bank loan	184,308	184,308
Finance lease liabilities	310,141	288,117
Total	494,449	472,425

On 22 July 2009, the group acquired a 28,891 square foot pharmaceutical freehold facility in Citywest, Co. Dublin for total consideration of €3.75 million. This acquisition was financed by €0.90 million in cash and €2.85 million in secured borrowings; (€2.10 million in the form of a 15 year mortgage and €0.75 million in the form of a four year equipment lease). During the same year, additional laboratory equipment amounting to €0.50 million was also acquired under a separate finance lease. In relation to both acquisitions of equipment acquired under finance leases, the equipment was initially purchased in cash and subsequently funded by finance leases over the equipment acquired.

The terms and conditions of outstanding loans and finance leases are as follows:

	Nominal interest rate	Year of maturity	2010 €	2009 €
Secured bank loan	LIBOR + 2.5%	2024	1,933,044	2,052,255
Finance lease liabilities	7.14%	2013	392,944	509,943
Finance lease liabilities	7.56%	2013	524,647	695,765
Total interest bearing liabilities			2,850,635	3,257,963

Merrion Pharmaceuticals plc

Notes (continued)

14. Loans and borrowings (continued)

Finance lease liabilities are payable as follows:

	2010		2009	
	Minimum lease payments €	Present value of minimum payments €	Minimum lease payments €	Present value of minimum payments €
Within one year	367,491	310,141	367,491	288,117
After one year but not more than five years	649,897	607,450	1,017,388	917,591
More than five years	-	-	-	-
Total finance lease payments	1,017,388	917,591	1,384,879	1,205,708

15. Accrued and other payables

Current	2010 €	2009 €
Accrued liabilities	460,919	521,554
Accrued social welfare costs	173,157	134,735
Amounts owed to related parties	90,422	374,606
Total accrued and other payables	724,498	1,030,895

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

16. Share capital

	2010 €	2009 €
<i>Authorised</i>		
100,000,000 ordinary shares of €0.01 each	1,000,000	1,000,000
10,000,000 convertible preference shares of €0.01 each	100,000	100,000
	1,100,000	1,100,000
<i>Issued, called up and fully paid</i>		
17,131,509 (31 December 2009: 17,131,509) ordinary shares at €0.01 each	171,315	171,315

There were no new ordinary shares in Merrion issued during the year ended 31 December 2010.

On 20 January 2009, 300,000 new ordinary shares in Merrion, at a price of €3 per share, were issued and allotted to Novo Nordisk A/S, for total consideration of €900,000. These shares were admitted to trading on the Irish Stock Exchange on the same date. This investment by Novo Nordisk A/S represents a 1.8% shareholding in Merrion.

Merrion Pharmaceuticals plc

Notes (continued)

16. Share capital (continued)

Also during 2009, a further 164,383 new ordinary shares in Merrion were issued and allotted to Enterprise Ireland at a price of €3.65 per share, for total consideration of €99,998. These shares were admitted to trading on the Irish Stock Exchange on 21 October 2009.

During the year ended 31 December 2010, no ordinary shares were issued to certain employees and directors in conjunction with the exercise of their vested share option awards. During 2009, a total of 7,969 ordinary shares were issued to employees and directors in conjunction with the exercise of their vested share option awards, in line with the terms and conditions set out in note 18 to the consolidated financial statements. These options were exercised at an average price of €0.25 per option. All issued shares were fully paid at the year end. The proceeds received from these share issues have been used by the company for general corporate purposes.

17. Warrant reserve

On 21 December 2010, as part of a collaboration and option agreement entered into with Novo Nordisk A/S, Merrion issued a warrant to Novo Nordisk A/S to acquire up to €1,500,000 in value of ordinary shares of Merrion at an exercise price of €2.73 per share. In addition, Merrion issued a put option to Novo Nordisk A/S to acquire up to €500,000 in value of ordinary shares in Merrion at an exercise price of €2.73 per share.

The warrant and put option are exercisable for 20 business days commencing on the day following the signing of a license agreement with Novo Nordisk A/S, which is expected to occur within nine months from the date of agreement. At 31 December 2010, warrants and put options have been issued over ordinary shares as follows:

Type of instrument	Number of warrants/put options outstanding	Date warrant/ put option granted	Exercise price per ordinary share €	Share price at date of issue €	Fair value of warrant / put option at date of issue €
Warrant	549,451	21 December 2010	2.73	2.73	0.33
Put option	183,150	21 December 2010	2.73	2.73	0.32

As the warrant and put option give rise to an obligation for the group to issue, if called to do so, a fixed number of shares for a fixed amount of money in functional currency terms, the fair value of the warrant and put option are classified as a separate component in equity. These instruments are measured at fair value through the income statement at date of issue. Accordingly, included in finance expense for the year ended 31 December 2010, is €23,960 (2009: €nil), comprising the fair value of the warrant of €182,570, (2009: €nil), offset by the fair value of the put option of €58,610 (2009: €nil).

The following assumptions were used to estimate the fair values of the warrant and put option granted, which were measured using the Black Scholes Merton ('BSM') option pricing model at the date of issue:

Assumptions

Expected volatility ⁽¹⁾	33%
Annual return	0.54%
Risk-free interest rate ⁽²⁾	0.541%
Expected term (years) ⁽³⁾	0.83 years
Dividend yield	Nil
Exercise price	€2.73

(1) The expected volatility is based on the volatility of Merrion's share price for nine months

(2) The risk free interest rate is based on a nine month zero coupon Eurozone Treasury gilt rate at date of issue

(3) It is expected that a license agreement will be entered into with nine months from the date of agreement.

Merrion Pharmaceuticals plc

Notes (continued)

18. Share-based payments

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

An aggregate of 282,608 ordinary shares were reserved for issuance under the Plan. No share options can be granted after 8 August 2016. On 15 March 2007, the number of ordinary shares reserved for issuance under the plan was increased by 1,086,956. At 31 December 2010, total ordinary shares reserved for issuance under this plan was 2,046,619 (2009: 1,696,617) following the reservation of a further 350,000 (2009: 327,053) ordinary shares during 2010.

Total share options outstanding at the end of the reporting period are summarised as follows:

	Number of share options	Weighted average exercise price	Weighted average fair value	Weighted average remaining contractual life
Outstanding at 1 January 2009	991,631	€2.56	€1.49	6.46 years
Granted	423,000	€3.92	€2.12	
Exercised	(7,969)	€0.25	€0.34	
Forfeited	(61,175)	€2.60	€1.28	
Outstanding at 31 December 2009	1,345,487	€3.02	€1.69	5.75 years
Granted	33,000	€3.10	€1.59	
Forfeited	(45,233)	€1.08	€2.04	
Outstanding at 31 December 2010	1,333,254	€2.94	€1.64	4.46 years

The number of share options exercisable at 31 December 2010 was 800,880 (2009: 418,451).

At 31 December 2010, total unrecognised share-based compensation expense relating to unvested share options outstanding of 429,875 (2009: 796,791) amounted to €549,495 (2009: €959,639), which the company expects to recognise over a weighted average vesting period of 2.12 years (2009: 2.47 years).

Of the share options granted in the periods above, no share options were granted to non-employees in the years ended 31 December 2010 and 2009.

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

	2010 €	2009 €
Administrative expenses	236,743	360,137
Research and development expenses	83,663	162,445
Total share-based compensation expense	320,406	522,582

Merrion Pharmaceuticals plc

Notes (continued)

18. Share-based payments (continued)

Employee share options typically vest annually over a period of three years from date of grant and expire 7 to 10 years from date of grant. However, options that are currently outstanding provide that in the event of a change of control resulting in a change in beneficial ownership of at least a majority of the company's then existing voting ordinary shares, all of the options that are unvested and unexercisable become immediately vested and exercisable as of a date prior to the transaction determined by the Board of Directors. Additionally, such share options typically provide that upon the death or disability of the optionee or upon the termination of such optionee's employment with the company without cause, all of the options that are unvested or unexercisable become immediately vested and exercisable. The maximum contractual term of options outstanding at 31 December 2010 is 9 years.

The group measures the fair value of its share option grants using the Black Scholes Merton ('BSM') option-pricing model. The fair value of the share option awards was calculated using a BSM option-pricing model under the following assumptions:

	31 December 2010		
Grant date	15 December 2010		
Date of earliest exercise	15 December 2010		
Date of expiration	15 December 2017		
Market price	€3.10		
Fair value	€1.59		
<i>Assumptions</i>			
Expected volatility ⁽¹⁾	60%		
Dividend yield	Nil		
Risk-free interest rate ⁽²⁾	2.28%		
Expected term (years) ⁽³⁾	4.7 years		
	31 December 2009		
Grant date	14 January 2009	11 February 2009	17 June 2009
Date of earliest exercise	10 December 2009	11 February 2009	17 June 2009
Date of expiration	10 December 2015	11 February 2016	17 June 2016
Market price	€3.35	€4.10	€4.14
Fair value	€1.68	€2.11	€2.13
<i>Assumptions</i>			
Expected volatility ⁽¹⁾	60%	60%	60%
Dividend yield	Nil	Nil	Nil
Risk-free interest rate ⁽²⁾	2.44%	2.44%	2.44%
Expected term (years) ⁽³⁾	4.7 years	4.7 years	4.7 years

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

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

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

Merrion Pharmaceuticals plc

Notes (continued)

19. Financial instruments and risk management

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

The group manages its financial risk exposures on a group wide basis and seeks to reduce the exposure of significant risks through a process of controlling, monitoring and reporting. Planning and budgetary processes increase the opportunity for early warnings of financial risk. Monthly financial reporting aids the identification of risk areas by management. Risk management is overseen by the Audit Committee, which supervises activities of management with regard to complying with the Group's risk management policies and procedures. The Board of Directors reviews the adequacy of the risk management framework in relation to the risks faced by group. The group's approach to the management of these financial risks is further described for each risk area below.

(a) Financial assets and liabilities

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

	Loans and receivables €	Liabilities at amortised cost €	Total carrying value €	Fair value €
31 December 2010				
Cash and cash equivalents	3,310,387		3,310,387	3,310,387
Trade receivables	936,764		936,764	936,764
Other receivables	32,265		32,265	32,265
Tax receivable	6,158		6,158	6,158
Trade payables		(280,850)	(280,850)	(280,850)
Accrued liabilities		(460,919)	(460,919)	(460,919)
Amounts owing to related parties		(90,422)	(90,422)	(90,422)
Loans, borrowings and finance leases		(2,850,635)	(2,850,635)	(2,850,635)
At 31 December 2010	4,285,574	(3,682,826)	(256,434)	(256,434)
31 December 2009				
Cash and cash equivalents	7,218,097		7,218,097	7,218,097
Trade receivables	1,926,142		1,926,142	1,926,142
Other receivables	15,824		15,824	15,824
Value added tax receivable	23,839		23,839	23,839
Trade payables		(456,504)	(456,504)	(456,504)
Accrued liabilities		(521,554)	(521,554)	(521,554)
Amounts owing to related parties		(374,606)	(374,606)	(374,606)
Loans, borrowings and finance leases		(3,257,963)	(3,257,963)	(3,257,963)
At 31 December 2009	9,183,902	(4,610,627)	4,573,275	4,573,275

Merrion Pharmaceuticals plc

Notes (continued)

19. Financial instruments and risk management (continued)

(b) Estimation of fair values

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

Cash and cash equivalent including short term deposits

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

Trade and other receivables and trade payables

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

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

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

Loans and borrowings

Fair value for loans and borrowings is calculated based on the present value of future contractual principal plus interest cash flows, discounted at appropriate market rates of interest.

Financial instruments: warrant and put option

The fair value of the warrant and put option are measured using the Black Scholes Merton ('BSM') option pricing model at the date of issue.

We disclose our financial instruments that are measured in the statement of financial position at fair value using the following fair value hierarchy for valuation inputs. The hierarchy prioritises the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of three levels which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- Level 1: Inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.
- Level 2: Inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model- based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets and liabilities.
- Level 3: Inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The following table sets forth our assets measured at fair value as at 31 December 2010:

	Quoted Prices in Active Markets Level 1	Other Observable Inputs Level 2	Unobservable Inputs Level 3	Total
	€	€	€	€
Warrant	-	-	182,570	182,570
Put option	-	-	(58,610)	(58,610)

Merrion Pharmaceuticals plc

Notes *(continued)*

19. Financial instruments and risk management *(continued)*

(c) Credit risk

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet contractual obligations, and arises principally from the group's cash and cash equivalents and its receivables from customers and the Irish government, in respect of the R&D tax credits receivable.

The current assets of the group consist primarily of cash and cash equivalents, trade receivables and R&D tax credits receivable. The group limits its exposure to credit risk associated with cash and cash equivalents by diversifying and placing funds on deposit with a number of different financial institutions approved by the board of directors. The group currently holds cash and cash equivalents primarily in four different financial institutions, each of which is covered by the Irish government guarantee scheme for money held in Irish financial institutions.

The group's exposure to risk attached to trade receivables is influenced by the size and profitability of each customer. Revenue recognised during the financial year ended 31 December 2010 is attributable to four customers. 93% (2009: 98%) of the total revenue earned during the year ended 31 December 2010 was attributable to services performed for a single customer. The company has been transacting with this customer for the past three years and to date, losses have not occurred. At 31 December 2010 and 2009 €Nil of our trade receivables balance was past due but not impaired. Our provision for doubtful debts was €Nil at both 31 December 2010 and 2009.

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

Generally, initial customer fees are invoiced on initiation of a study with final fees being invoiced on completion of a work order or study to ensure that credit risk is minimised. Unpaid balances are regularly monitored for impairment and to date bad debts have not been an issue.

(d) Liquidity risk

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

The group has a limited operating history and has not yet commercialised any products or generated any product revenue. As at 31 December 2010, the group had an accumulated deficit of €32,868,446 (2009: €30,357,970). The group has incurred losses in each year since its inception in December 2003. Net losses were €2,510,476 (2009: €1,629,095) for the year ended 31 December 2010.

The group expects to continue reporting operating losses in the short term, as it continues research activities and conducts development of, and seeks regulatory approvals for, initial drug candidates, and commercialises any approved drugs. However, having entered into feasibility studies with numerous new partners in 2010, the group expects to generate revenues from an increased number of partners during 2011.

Merrion Pharmaceuticals plc

Notes (continued)

19. Financial instruments and risk management (continued)

(d) Liquidity risk (continued)

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

The following is an analysis of the maturity of contractual undiscounted cash flows relating to financial liabilities at the end of the reporting period:

	Total carrying value €	Total contractual cash flows €	Less than 1 year €	Between 1-2 years €	Between 2-5 years €	More than 5 years €
31 December 2010						
Trade payables	280,850	280,850	280,850	-	-	-
Amounts owed to related parties	90,422	90,422	90,422	-	-	-
Accrued liabilities	460,919	460,919	460,919	-	-	-
Finance lease liabilities	917,591	1,017,388	367,491	367,491	282,406	-
Secured bank loan	1,933,044	2,503,517	184,308	184,308	552,924	1,581,977
At 31 December 2010	3,682,826	4,353,096	1,383,990	551,799	835,330	1,581,977
31 December 2009						
<i>Non-derivative financial liabilities</i>						
Trade payables	456,504	456,504	456,504	-	-	-
Amounts owed to related parties	374,606	374,606	374,606	-	-	-
Accrued liabilities	521,554	521,554	521,554	-	-	-
Finance lease liabilities	1,205,708	1,384,879	367,491	367,491	649,897	-
Secured bank loan	2,052,255	2,687,825	184,308	184,308	552,924	1,766,285
At 31 December 2009	4,610,627	5,425,368	1,904,463	551,799	1,202,821	1,766,285

Merrion Pharmaceuticals plc

Notes (continued)

19. Financial instruments and risk management (continued)

(e) Market risk

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

Foreign currency risk

The Euro is the primary currency in which the group's business transactions are conducted and the Euro is used as the presentation currency of the group for financial reporting. A portion of the business transactions of the group is carried out in the United States and the United Kingdom. At 31 December 2010, 46% and 4% (2009: 28% and 4%) of the trade payables of the group were denominated in US dollars and GBP respectively.

During the year ended 31 December 2010, the group entered into additional partner agreements where terms and conditions are denominated in US dollars. As a result, all future revenue associated with these agreements, will be translated at the rate prevailing on the date of transaction. A strengthening of the Euro against the US dollar could therefore reduce earnings. Consequently, fluctuations in the rate of exchange between the US dollar, Sterling and the Euro will affect period to period comparisons of reported results.

The group's operations are predominantly located in the Eurozone, consequently, the group has only limited exposure to non-Euro exchange rate risk. Given the low level of exposure, the group policy is not to hedge this statement of financial position risk.

The table below summarises the group's currency exposure. Such exposure comprises the monetary assets and monetary liabilities that are not denominated in the functional currency of the operating unit involved. At the end of the reporting period, these exposures were as follows:

	2010	2009
	€	€
Trade and other receivables		
US dollar	759,441	-
Sterling	-	-
Total foreign currency risk on trade and other receivables	<u>759,441</u>	<u>-</u>
Trade and other payables		
US dollar	(131,084)	781,558
Sterling	(11,869)	(17,719)
Total foreign currency risk on trade and other payables	<u>(142,953)</u>	<u>(763,839)</u>

Merrion Pharmaceuticals plc

Notes (continued)

19. Financial instruments and risk management (continued)

(e) Market risk (continued)

A 10 percent strengthening of the Euro against the following currencies, based on outstanding financial assets and liabilities at 31 December 2010 and 2009, would have increased/(decreased) net loss after tax by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

	2010 Impact on net loss €	2009 Impact on net loss €
US dollars	(151,830)	(93,889)
Sterling	13,713	(15,370)

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

Interest rate risk

At 31 December 2010, the group had cash and cash equivalents of €3,310,387 (2009: €7,218,097), a significant (94%) amount (2009: 95%) of which was on deposit in fixed and variable rate, US dollar and Euro accounts. Deposit interest income of €129,754 (2009: €42,700) was earned during the year ended 31 December 2010.

Variable interest rates on cash and cash equivalents are generally based on the appropriate Euro Interbank Offered Rate or bank rates dependent on principal amounts on deposit. At the year end, the company had a loan facility of €2.1 million with a variable rate of 2.5% above the base lending rate per annum. Any interest rate changes will directly affect the amount of interest repayable on this debt. Interest rates on finance lease obligations are fixed, as set forth in note 17 to the consolidated financial statements.

A 10 percent increase in market rates of interest available on deposit accounts would have reduced the net loss after tax earned by the group during the years ended 31 December 2010 and 2009 by €3,272 and €9,709 respectively. A 10% decrease in market rates of interest would have had the equal but opposite effect on net loss after tax in 2010 and 2009. This analysis assumes that all other variables remain constant.

Capital management

The primary objective of the group when managing capital is to sustain future development of the business. The board of directors approves and monitors any changes to the group's capital structure. The board seeks to maintain a balance between expected future costs and cash available to the group. Members of the management team continue to research the possibility of future funding from investors in the US and Europe, though no decisions have yet been made. The company did not have any externally imposed capital requirements at 31 December 2010 and 2009.

Merrion Pharmaceuticals plc

Notes (continued)

20. Operating leases

Annual non-cancellable operating lease rentals are payable as follows:

Non-current	2010	2009
	€	€
Within one year	35,989	216,672
Between one and five years	49,992	89,000
Thereafter	-	-
Total minimum rental payments	85,981	305,672

The group leases its facility in Wilmington, NC, USA. This is a twelve month lease and it expires on 30 November 2011. The group has an equipment lease agreement that is due to expire in December 2013 that covers much of the group's research and development equipment. The group pays all executory costs such as maintenance and insurance. The group paid €162,512 in leasing expenses for the fiscal year ended 31 December 2010 and €231,298 for the year ended 31 December 2009.

21. Commitments and contingencies

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

22. Related parties

On 16 February 2004, the group acquired four platform drug delivery technologies, together with certain equipment used solely in the research and development of those technologies from a shareholder pharmaceutical company, Elan Corporation, plc ("Elan"). Under the terms of this agreement, the group has an obligation to pay Elan, (which holds a 2% shareholding in Merrion), royalties of 10% less applicable costs, in connection with revenue attributable to the patents previously purchased from Elan. As at and for the year ended 31 December 2010, €74,839 (2009: €347,078) was attributable and payable to Elan in this respect.

On 23 December 2003, the group entered into an equipment lease agreement with Elan pursuant to which it leases certain laboratory equipment from Elan for a rental fee of €2,083 a month for a period of four years and nine months from the date of the agreement. This agreement was extended for an additional five years on 29 January 2007, and now expires on 23 September 2013. At 31 December 2010, €2,083 was payable to Elan in relation to leasing costs (31 December 2009: €2,083).

Merrion Pharmaceuticals plc

Notes (continued)

22. Related parties (continued)

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

	2010 €	2009 €
Salaries	1,063,847	972,122
Bonus	200,321	110,472
Other benefits	14,698	12,752
Pension benefits	66,329	63,884
Share-based compensation expense	275,154	392,725
Total key management personnel compensation	1,620,349	1,551,955

The share-based payment amounts disclosed above represent the share-based compensation expense recognised in the income statement in the years ended 31 December 2010 and 2009 attributable to key management personnel. At 31 December 2010, €12,500 was payable to Merrion's key management in lieu of director fees (2009: €25,445).

23. Notes to the company statement of financial position

a) Investment in subsidiaries

	2010 €	2009 €
Cost		
Balance at beginning of year	30,348,489	29,947,673
Share-based compensation	252,158	400,816
Balance at end of year	30,600,647	30,348,489

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

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company statement of financial position (continued)

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

b) Trade and other receivables

	2010	2009
	€	€
Amounts due from subsidiary undertakings	9,920,279	9,920,279
Other receivables	123	-
	<hr/>	<hr/>
Amounts due from subsidiary undertakings	9,920,402	9,920,279

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

c) Cash and cash equivalents

	2010	2009
	€	€
Bank balances	1,279	251
Call deposits	584,990	569,074
	<hr/>	<hr/>
Total cash and cash equivalents	586,269	569,325

d) Amounts due to subsidiaries

	2010	2009
	€	€
Amounts due to subsidiary undertakings	1,960,146	1,727,843
	<hr/>	<hr/>

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

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company statement of financial position (continued)

e) Share capital

	31 December 2010	31 December 2009
	€	€
<i>Authorised</i>		
100,000,000 ordinary shares of €0.01 each	1,000,000	1,000,000
10,000,000 convertible preference shares of €0.01 each	100,000	100,000
	1,100,000	1,100,000
<i>Issued, called up and fully paid</i>		
17,131,509 (31 December 2009: 17,131,509) ordinary shares at €0.01 each	171,315	171,315

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

f) Warrant reserve

Details of the warrant reserve are outlined in note 17 to the consolidated financial statements.

g) Financial instruments

Financial instruments in the company primarily take the form of loans to and from subsidiary undertakings. The fair value of loans to and from group undertakings at the end of the reporting period is approximately equal to their carrying values.

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

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

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

Merrion Pharmaceuticals plc

Notes (continued)

23. Notes to the company statement of financial position (continued)

h) Principal subsidiary undertakings

Name	Country of incorporation	Proportion held by group	Registered office
Merrion Pharmaceuticals Holdings Limited	Ireland	100%	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland
Merrion Pharmaceuticals Ireland Limited	Ireland	100%	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland
Merrion Pharmaceuticals LLC	USA	100%	219 Racine Drive Suite D Wilmington North Carolina USA
Merrion Research I Limited	Ireland	100%	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland
Merrion Research II Limited	Ireland	100%	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland
Merrion Research III Limited	Ireland	99%	3200 Lake Drive Citywest Business Campus Dublin 24 Ireland

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

The following director, together with the company secretary, holds the following shares in Ramalex Limited in the following proportions:

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

Merrion Pharmaceuticals plc

Notes *(continued)*

24. Subsequent events

There have been no subsequent events that would require disclosure of, or adjustment in, the condensed consolidated financial statements.

25. Approval of financial statements

The board of directors approved these financial statements on 11 March 2011.



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