

Corporate governance report for BioGaia AB 2008

Corporate governance in BioGaia

BioGaia is a Swedish public limited company whose class B shares are listed on the small caps list of the Nasdaq OMX Nordic Exchange Stockholm. The company's operations are governed by the General Meeting of Shareholders, the Board of Directors and the Managing Director in accordance with the Swedish Companies Act, the Articles of Association and the Swedish Code of Corporate Governance.

Articles of Association

According to BioGaia's Articles of Association, the Company shall engage in the import, development, production and marketing of pharmaceuticals, natural health products, animal feed and food products and other activities compatible therewith. The company is domiciled in Stockholm, Sweden. The Articles of Association can be viewed on BioGaia's website under the heading "Corporate Governance".

General Meeting of Shareholders

The General Meeting of Shareholders is the highest decision-making body through which the shareholders exercise their influence over the Company. The Annual General Meeting (AGM) elects the members of the Board of Directors. The responsibilities of the AGM also include adoption of the Company's income statements and balance sheets, approval of the appropriation of disposable profits and discharge from liability for the members of the Board and the Managing Director.

2008 AGM

The 2008 AGM of BioGaia was held on 22 April 2008 and was attended by shareholders representing 42.3% of the total number of votes in the Company. The AGM was also attended by the Company's Managing Director, the Board members elected by the previous AGM (aside from one retiring member), all of the Board members elected by the year's AGM and the Company's independent auditor.

2009 AGM

The 2009 AGM will be held on Wednesday, 22 April 2009, 4:00 p.m., at World Trade Center, Kungsbron 1, in Stockholm.

Notice of AGM

Notice of the AGM is given through an announcement in the Official Gazette (Post- och Inrikes Tidningar and Svenska Dagbladet) no earlier than six weeks and no later than four weeks prior to the Meeting.

Nominating Committee

The tasks of the Nominating Committee are to prepare recommendations regarding election and remuneration for decision by the AGM.

The 2008 AGM resolved that the Nominating Committee would be appointed according to the following: "The Board Chairman shall convene the three largest shareholders in the company, each of which has the right to appoint a member to the Nominating Committee together with the Board Chairman. In determining the composition of the Nominating Committee, the largest shareholders in terms of voting power shall be based on the ownership conditions on 30 June 2008. The Nominating Committee shall be chaired by the member representing the largest shareholder. If any of the three largest shareholders should waive this right, the shareholder next in order of size will be given the opportunity to appoint a member".

In accordance with the AGM's resolution, the Nominating Committee was appointed according to the ownership conditions on 30 June 2008. Annwall & Rothschild Investment AB, the largest shareholder, declined participation in the Nominating Committee, which thus consisted of Lars Hallén, the second largest shareholder, David Dangoor, Board Chairman and the third largest shareholder, and Sven Zetterqvist, representing Livförsäkringsaktiebolaget Skandia, the fourth largest shareholder. The Nominating Committee has appointed Sven Zetterqvist as its chairman, since Lars Hallén will be unable to attend the upcoming AGM.

The Nominating Committee will prepare recommendations for the following matters to be put before the 2009 AGM for resolution: recommendations for election of the Chairman of the AGM, Board of Directors and Board Chairman, recommendation of fees for the members of the Board and auditors, and recommendations regarding appointment of the Nominating Committee ahead of the 2010 AGM.

In 2008 the Nominating Committee held one meeting and maintained continuous informal contact. No remuneration has been paid to the members for their work on the Nominating Committee.

All shareholders have had the opportunity to contact the Nominating Committee with recommendations for Board candidates for further evaluation with the framework of the Committee's work. No views or proposals have been submitted to the Nominating Committee as of today's date.

Board of Directors

According to BioGaia's Articles of Association, the Board shall consist of at least five and at most eight members with no more than three deputies. The Board is elected yearly by the AGM to serve for the period until the end of the following AGM. In 2008 the Board has consisted of seven members elected by the AGM with no deputies. One Board member, Jan Annwall, a member of the Board since 1990, is employed by the Company and is also a major shareholder. The six remaining members are independent from both the Company and its management. BioGaia's independent legal counsel has been appointed to serve as Secretary at Board meetings. The Managing Director is not a member of the Board but is a co-opted member of all Board meetings. Other executives in the Company take part in Board meetings in order to present reports. The Board has adopted rules of procedure that includes instructions for the division of responsibilities between the Board and the Managing Director and the structure of Board activities during the year. Furthermore, the Board has adopted instructions for the Managing Director, authorisation instructions including instructions for liquidity management and an equality plan. The rules of procedure, Managing Director's instructions, authorisation instructions and equality plan are reviewed at least once a year.

The Board decides on matters related to the Group's overall strategy, organisation and management. The Board held seven minuted meetings and one strategy seminar in 2008. At these meetings the Board has discussed budgets, business plans, financial accounts, capital expenditure, financial reports and major agreements. The purpose of the strategy seminar was to discuss the Company's long-term strategies. Stefan Elving and Paula Zeilon were each absent from one meeting and Thomas Flinck was absent from two meetings. The other Board members attended all meetings.

The Board of Directors continuously assesses its own performance through both open discussions and a written evaluation. The results of the written evaluation are submitted to the Nominating Committee.

Board fees

The 2008 AGM resolved that Board fees would be paid in an amount of SEK 200,000 to the Board Chairman and SEK 100,000 to each of the other Board members not employed by the Company.

Board Chairman

The Chairman supervises the work of the Board and is responsible for ensuring that the Board carries out its duties in accordance with the Swedish Companies Act and the rules of procedure. Through ongoing contact with the Managing Director, the Chairman continuously monitors the Company's development and ensures that the Board is provided with the information necessary to carry out its duties. David Dangoor has been Board Chairman since the 2007 AGM.

Managing Director

The Managing Director is responsible for overseeing the Company's business development and for supervising and coordinating its day-to-day operations. The Board has established instructions for Managing Director which among other things regulate his management and development of the Company and the provision of reports and decision data to the Board. The Managing Director prepares the requisite information and decision data such as reports on the Company's finances, the order situation, significant business and strategic issues prior to Board meetings presents reports and motivates proposals for decision. Furthermore, the Managing Director continuously informs the Board Chairman about the Company's financial and business situation. Every year the Board carries out an evaluation of the Managing Director's performance in which no member of the executive management is present.

Executive Management

BioGaia's Group Executive Management consists of the 10 individuals. The Group Executive Management is headed by the Managing Director and is responsible for planning, supervising and monitoring the Company's day-to-day operations. Minuted meetings are normally held every four weeks. The responsibilities and powers of the Managing Director are regulated by the Swedish Companies Act and by the instructions that are adopted by the Board. The responsibilities and powers of the Group Executive Management are defined in the established job descriptions and authorisation instructions.

Remuneration Committee

The Board has appointed a Remuneration Committee consisting of the Board Chairman David Dangoor and Board member Stefan Elving. The task of the Remuneration Committee is to prepare recommendations for remuneration and other terms of employment of the Managing Director and other senior executives who together make up the Group Executive Management. The principles for remuneration to senior executives are resolved on by the AGM. The Remuneration Committee prepares its recommendations based on these principles.

Auditors

BioGaia's independent auditors are normally appointed by the AGM to serve for a period of four years. The 2007 AGM elected Lena de Rosche and Ivar Verner (deputy), both from Grant Thornton Sweden AB, as the Company's auditors until the end of the 2010 AGM. By decision of the AGM, auditing fees are paid according to approved account.

The auditors examine the administration of the Company by the Board of Directors and the Managing Director and the quality of the Company's financial reporting. At the request of the Board, the auditors review the semi-annual report and the year-end report.

The auditors report the results of their review to the shareholders through an audit report, which is presented to the AGM. In addition, the auditors submit written and oral reports to the executive management and the Board. The auditors takes part in the Board meeting preceding publication of the year-end report to present the results of their audit of the annual accounts and observations from ongoing examination of the company's internal control during the financial year.

Grant Thornton has also provided certain tax-related advice and performed other audit-related services. Disclosures about remuneration to the auditors can be found in Note 6.

In view of the Company's limited size and volume of transactions, the Board has decided not to set up any audit committee. Instead, the entire Board of Directors meets with the auditors at least once a year without the presence of the Managing Director of other member of the executive management.

The Board's report on internal control over financial reporting for the financial year 2008

Introduction

As stated in the Swedish Companies Act and the Swedish Code of Corporate Governance (the Code), the Board of Directors is responsible for establishing and maintaining adequate internal control. This report has been prepared in accordance with sections 10.5 and 10.6 of the Swedish Code of Corporate Governance, and is accordingly limited to internal control over financial reporting.

Control environment

The Board is responsible for ensuring that the Company's organisation is suitably structured so that the financial accounts, cash management and other financial conditions can be controlled satisfactorily.

Every year, the Board of Directors adopts rules of procedure for the Board's activities and instructions regulating the division of responsibilities between the Board and the Managing Director. The rules of procedure state which matters require approval or authorisation from the Board. At Board meetings, the Managing Director reports on matters requiring treatment by the Board.

The Managing Director ensures that the Board is provided with the objective, detailed and relevant information needed for the Board to make well founded decisions and that the Board is continuously informed about the Company's business development and financial position.

Aside from the rules of procedure between the Board and the Managing Director, BioGaia's control environment is based on the Company's organisation and operating structure, in which roles and responsibilities are defined. There is a high level of employee awareness about the importance of maintaining good control over financial reporting. The Company's financial development is assessed and monitored monthly. Financial reports and summaries are prepared by the Group's finance department and are presented to the Board quarterly and to the executive management monthly.

BioGaia's values

BioGaia also has a set of shared values and the Company's employees are well aware of these (see box below).

BioGaia's values

- We believe in our mission and that our natural products contribute to improving human health
- We aim to be innovative, fast, informal and smart problem-solvers by using conventional and unconventional methods
- We listen to our customers and try quickly meet their needs by building strong partnerships
- We strive continuously for high quality, delivery reliability and profitability
- We are ethical, honest, open and supportive in dealing with our colleagues and partners
- We take personal responsibility for the success of the company

Risk assessment

The Company works continuously with risk assessment and risk management to ensure that the risks to which the Company is exposed are managed with the limits ultimately established by the Board. The executive management continuously analyses the Company's business processes with regard to efficiency and risks.

The most critical business processes and the absolutely largest values, both assets and business/product development, are found in the Parent Company. In addition, the bulk of sales take place in the Parent Company. Processes that are deemed to be of special importance to BioGaia are sales including quality assurance, R&D and manufacturing.

Control activities

The risks identified in financial reporting are managed through a number of control activities in the Company's processes. Processes and controls are reviewed and updated regularly in order to detect, prevent and correct any errors or deficiencies. The control structure also includes the division of powers and responsibilities and the executive management's monthly review of the Company's financial information.

Information and communication

BioGaia has information and communication paths that are designed to promote the completeness and accuracy of the financial reporting. Authorisation instructions and policies are distributed to all employees and can be viewed on the Company's intranet. Once or twice a year, all of BioGaia's employees meet to increase their knowledge about the Company's processes and goals and to exchange information and experiences. In 2008 the employees met for 2.5 days in September.

Monitoring

The executive management performs a yearly evaluation of the effectiveness of internal control. Every year, the Company's elected auditing firm, Grant Thornton Sweden AB, also audits a selection of BioGaia's routines and internal controls. The Board then evaluates this information and ensures that measures are taken in respect of the identified deficiencies and resulting recommendations.

The Company has no separate internal audit function. In view of the Company's size and the volume of transactions, the Board of Directors' has determined that there is no reason to set up a formal internal audit function.

Stockholm, 19 February 2009

The Board of Directors of BioGaia AB

This corporate governance report has not been examined by the Company's independent auditor.