developing advanced therapies

securing new partnerships

leveraging our business model

expanding beyond migraine

AR 2003

POZEN Inc.

developing advanced therapies

POZEN is a pharmaceutical company committed to developing therapeutic advancements for diseases with unmet medical needs. The Company focuses on areas in which it can improve efficacy, safety and patient convenience. One of POZEN's core strengths continues to be its drug development model and the ability to bring products through development quickly and efficiently. This model allows the company to strategically outsource parts of the drug development process, while maintaining control over critical functions.

securing new partnerships

leveraging our business model

Since its formation in 1996, POZEN has focused on developing products for migraine therapy, a multi-billion dollar global market. The Company has three product candidates that may offer patients and physicians the ability to customize migraine therapy. POZEN is committed to making its product candidates available to migraine patients and over the past year has signed development and commercial alliances with GlaxoSmithKline, Xcel Pharmaceuticals, and Nycomed.

expanding beyond migraine

to our stockholders

This time last year, I stated that one of our main priorities was to set the stage for commercial success by signing corporate partners to license our product candidates in development. In 2003, we did just that.

POZEN signed three development and commercialization alliances for our product candidates in 2003.

By far, the most significant of the three alliances was the agreement we signed with GlaxoSmithKline (GSK) for the U.S.-based development and commercialization of Trexima™, a novel combination of sumatriptan and naproxen sodium in a single tablet. Trexima is the proposed brand name for the migraine treatment using POZEN's MT 400™ technology. The agreement provides the opportunity for significant financial growth for POZEN. We will have the potential to receive development and regulatory milestone payments of up to $80 million, of which we received $25 million in 2003 and expect to receive another $15 million in 2004 as a result of starting the Phase III program. Once approved, there is the potential to receive up to $80 million in sales-performance milestone payments, as well as royalties on sales of marketed products.

As I write this letter, we are moving full-speed ahead and have initiated our Phase III program for Trexima, so you can expect to see a lot of news in the months to come. As of now, we expect to submit the Trexima New Drug Application (NDA) during the second-half of 2005. We are excited about the prospects of Trexima and believe it will be a major advance in the treatment of migraine.

Along with the alliance with GSK, we formed an alliance with Nycomed for the commercialization of MT 100™ in the Nordic Countries and with Xcel Pharmaceuticals for the commercialization of MT 300™ in the U.S. Nycomed's strong presence in the Nordic markets and Xcel's leadership in selling DHE products make them both partners of choice to maximize the potential of these two product candidates.

On the development and regulatory front, we met our target dates and submitted the NDA for MT 100 to the U.S. Food and Drug Administration (FDA) in July 2003 and submitted the results of the two-year rat carcinogenicity study in January 2004. Our NDA application for MT 100 is currently in review and we look forward to receiving FDA action at the end of May 2004. We also expect to hear back from the U.K. regulatory agency in mid-2004 about our MT 100 application. We continue to move forward in our partnering discussions and believe MT 100 will provide patients with an important therapeutic option to treat migraine and will be positioned as one of the best treatments for most patients.

Although POZEN made significant progress throughout 2003, we were disappointed to receive a not-approvable letter from the FDA for MT 300 in October 2003. While the FDA acknowledged that MT 300, POZEN's injectable product candidate for migraine, achieved its primary endpoint in both pivotal studies, the incidence of nausea, one of the associated symptoms of migraine, was statistically higher following MT 300 treatment versus placebo at two hours. However, we and our physician consultants believe the data clearly show that, on balance, MT 300 has a beneficial effect for patients. We are committed to working with the FDA to address the issues raised in the letter.

Looking beyond migraine, we took an important first step by signing an exclusive option agreement to license lornoxicam, a potent non-steroidal anti-inflammatory drug already marketed in Europe. We plan to leverage our knowledge in migraine pain and expand our drug development efforts into the broader area of pain management and lornoxicam will play a large role in this effort. If our first study in patients is positive, we will finalize the in-licensing of lornoxicam and advance it into full development, alone and possibly in combination with other agents.

Financially, POZEN is experiencing the success that comes from adhering to a highly disciplined business model and securing new partners for our product candidates. I am pleased to report that POZEN was cash flow positive and booked revenue for the first time in the history of the company. At the end of 2002 our cash balance was at $50 million. At the end of 2003, our cash balance was at $60 million. Near the midpoint of 2004, we find ourselves in a strong financial position and one that will enable us to continue development of our portfolio of product candidates and expand into new therapeutic areas beyond migraine. As the prospects for commercial success for MT 100 and Trexima get closer, so too does the prospect of sustainable profitability for POZEN.

Thank you for your continued interest in POZEN and your steadfast support.

John R. Plachetka, Pharm.D.
Chairman, President and Chief Executive Officer

MT 100™

TREATMENT Acute treatment of migraine, oral tablet.

Novel combination of naproxen sodium and metoclopramide hydrochloride.

STATUS NDA for MT 100 submitted to the FDA in July 2003.

Marketing Authorization Application (MAA) submitted to the U.K. regulatory agency in October 2002.

TREXIMA™

TREATMENT Acute treatment of migraine, oral tablet.

Novel combination of sumatriptan and naproxen sodium.

STATUS Trexima is in Phase III.

POZEN is responsible for pre-clinical, clinical and regulatory development activities and GSK is responsible for formulation development, manufacturing and commercialization.

MT 300™

TREATMENT Acute treatment of migraine, injectable.

Proprietary formulation of dihydroergotamine mesylate (DHE) in a pre-filled syringe.

STATUS NDA for MT 300 submitted to FDA in December 2002. POZEN received a not-approvable letter in October 2003.

POZEN is committed to working with the FDA to respond to the issues raised in the not-approvable letter.

One out of ten adults in the United States suffers from migraine, the majority of whom have never been diagnosed or treated with prescription medication. Many sufferers abandon treatment regimens out of frustration or concerns about side effects or efficacy. POZEN is striving to meet the market's demand by developing products that treat the full range of migraine attacks – mild, moderate, and severe, thereby allowing patients and doctors the ability to customize treatment for each type of migraine. POZEN has three product candidates that may provide improved treatment options for patients with migraine.

MT 100 is designed to provide effective migraine relief with fewer adverse cardiovascular side effects than other migraine therapies such as the triptans. Results from two head-to-head Phase III studies with the leading prescription drug for migraine, Imitrex® 50mg, show MT 100 provides comparable efficacy for migraine pain relief at two hours and over a 24-hour period. Results from the Phase III studies also demonstrate that MT 100 provides superior pain relief to placebo at two hours and over a 24-hour period. We believe MT 100 will provide an important therapeutic option for patients and physicians seeking an alternative to the triptans as well as other therapies.

developing advanced therapies

Trexima combines the pharmacologic activity of sumatriptan (5-$HT_{1B/1D}$ agonist) with naproxen sodium in a single tablet. Trexima is the proposed brand name for the migraine treatment using POZEN's MT 400 technology. We believe Trexima will represent the most significant step forward in migraine therapy since the introduction of triptan monotherapy in the 90's. Trexima is in Phase III development.

In a large Phase II study of nearly 1,000 patients, POZEN reported that a version of this combination of a triptan and naproxen sodium provided a faster onset and a longer duration of pain relief compared to the triptan alone or placebo. In the study, 65% of the patients taking the combination achieved pain relief at two hours versus 49% taking a triptan alone or 27% taking placebo.

Many patients who experience severe migraine attacks require an injectable therapy for effective pain relief. **MT 300**, a proprietary formulation of dihydroergotamine mesylate in a pre-filled syringe, is designed to provide significant and long-lasting pain relief for patients seeking a convenient injectable therapy.

securing new partnerships

POZEN partners with GlaxoSmithKline to develop and commercialize Trexima™, a novel migraine treatment.

In June 2003, POZEN and GSK formed an alliance to develop and commercialize Trexima, using POZEN's MT 400 technology. Trexima, a novel combination of sumatripan and naproxen sodium in a single tablet, may improve the effectiveness of acute treatment and provide relief for patients suffering from migraines. As the pioneer and the market leader in migraine treatment (sales of GSK's Imitrex totaled $1.1 billion in 2003), GSK is the partner of choice to commercialize Trexima in the U.S.

In signing the deal to develop and commercialize Trexima, POZEN and GSK executed one of the larger partnering deals of the year in the U.S. POZEN received an upfront and an initial milestone payment totaling $25 million in 2003 and will receive a milestone payment of $15 million in 2004 as a result of the commencement of the Phase III program. POZEN has the potential to receive additional development and regulatory milestone payments of up to $40 million, sales performance milestone payments of up to $80 million, and royalties on sales of marketed products.

The deal represents a true collaboration. POZEN will be responsible for the development of Trexima, including pre-clinical studies, clinical trials, and regulatory filings, while GSK will handle the formulation development, manufacturing and commercialization. Managed by a joint project committee, the team works closely to ensure the development timeline is on track. The team has met its first major goal by initiating the Phase III program for Trexima by the first-half of 2004.

Global sales of prescription pharmaceuticals for the treatment of migraine are estimated to approach $3.7 billion in 2005. Last year, POZEN signed three development and commercialization agreements as well as an option agreement to in-license a promising analgesic. In partnering with these pharmaceutical companies, we will be able to develop and market our product candidates more quickly and thus offer more treatment options for patients and their doctors.

ALLIANCES FORMED IN 2003

GLAXOSMITHKLINE

Develop and Commercialize Trexima in the U.S.

June 2003: POZEN and GSK formed an alliance for the development and commercialization of Trexima in the U.S., using POZEN's MT 400 technology. POZEN is responsible for pre-clinical, clinical and regulatory development activities and GSK is responsible for formulation, manufacturing and commercialization.

NYCOMED

Commercialize MT 100 in the Nordic Countries

July 2003: POZEN and Nycomed formed an alliance for the commercialization of MT 100 in the Nordic countries. Nycomed, a leading European pharmaceutical company with a strong Nordic base, is well positioned to maximize the potential of MT 100 in one of the most significant markets in Europe.

XCEL PHARMACEUTICALS

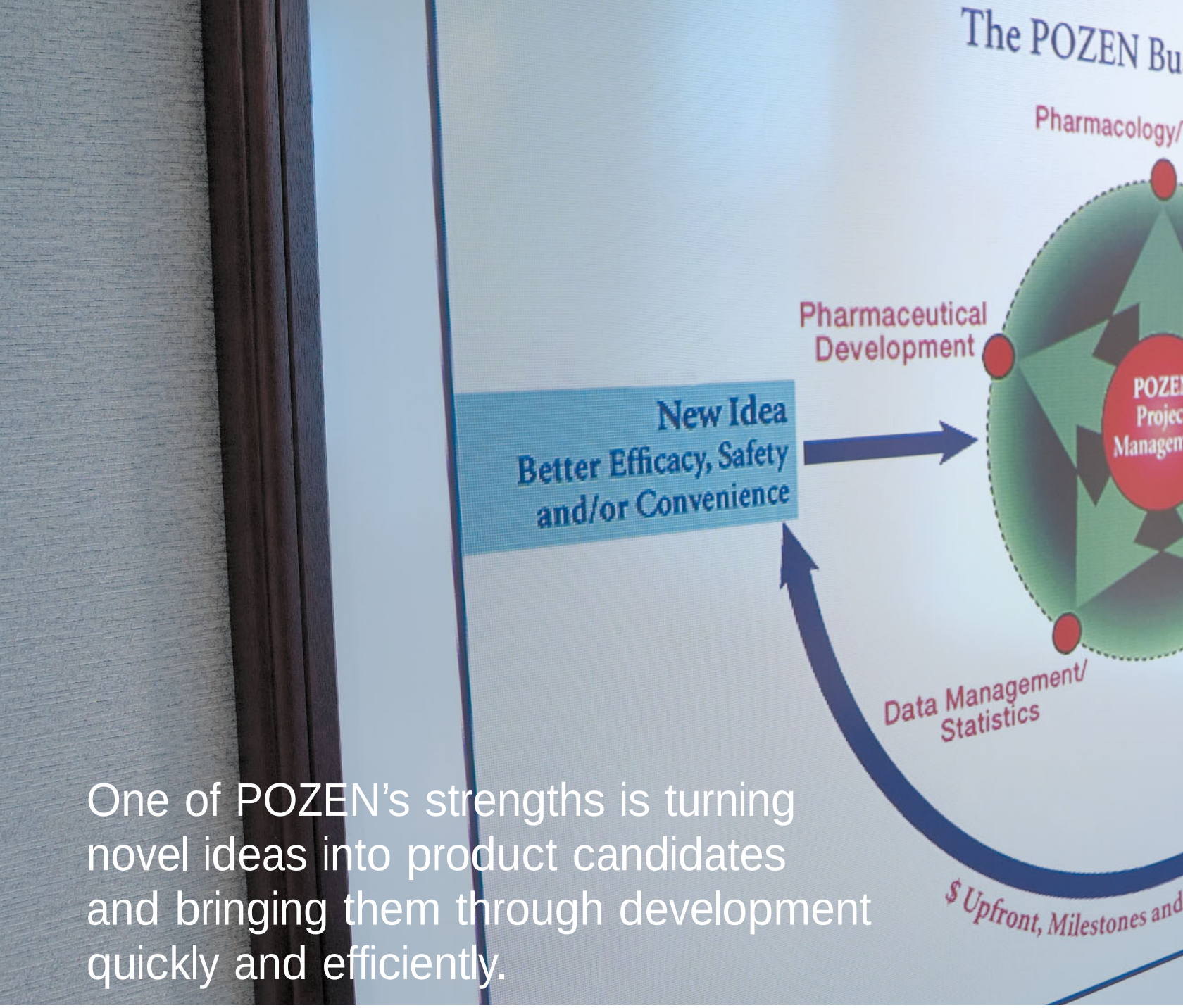
Commercialize MT 300 in the U.S.

September 2003: POZEN and Xcel Pharmaceuticals formed an alliance for the commercialization of MT 300. Xcel's leadership in selling DHE products (DHE-45® and Migranal®) as well as their dedicated neurology sales force make them a partner of choice to maximize the potential of MT 300.

NYCOMED

Option agreement to in-license lornoxicam

July 2003: POZEN and Nycomed signed an exclusive option agreement under which POZEN may acquire a license to lornoxicam, a potent non-steroidal anti-inflammatory drug. The collaboration serves as an important first step for POZEN to expand into new therapeutic areas, beyond migraine.



One of POZEN's strengths is turning novel ideas into product candidates and bringing them through development quickly and efficiently.

With no laboratories and no manufacturing facilities, POZEN's accomplishments suggest that bigger is not necessarily better. With only 30 employees, POZEN has been one of the most active researchers in the field of migraine. The company has conducted trials in over 300 clinical sites across the U.S. and has received six U.S. patents. Since our founding in 1996, we have developed what we believe to be one of the largest and most advanced product pipelines in the field of migraine.

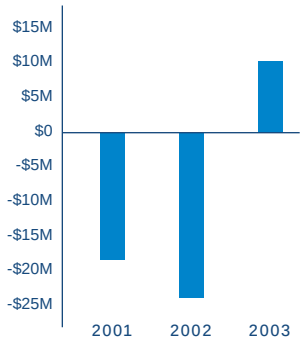
POZEN is made up not only of productive people, but also incredibly creative people. POZEN scientists are skilled at turning novel ideas into product candidates through combination therapy, new formulations, or innovations in drug delivery, and bringing them through development quickly and efficiently. How? This group of industry veterans has unique insight into pharmaceutical market dynamics coupled with expansive knowledge of the strengths, limitations, and interactions associated with current therapeutics.

leveraging our business model

In addition, the people at POZEN are talented and disciplined managers of their particular aspect of drug development. We maintain control over key functions of the drug development process such as design and management of pre-clinical and clinical studies and the development of product candidate formulations. We outsource functions as appropriate and work with strategic partners and contractors to run pre-clinical and clinical studies and manufacture product.

Perhaps most importantly for a small company, POZEN is a good steward of its cash outlay, dedicating over 70% of its spending to product development efforts.

CASH FLOW



expanding beyond migraine

Going forward, POZEN will expand its drug development beyond migraine and target new therapeutic areas.

Pain will be one area of focus. In the United States alone, products used to treat moderate to severe pain represent a multi-billion dollar market. The American Pain Society has suggested that pain should be recognized as the “fifth vital sign” – a factor as important in human health as blood pressure, heart rate, and respiration.

Many drugs currently on the market to treat pain are limited by side effects. POZEN intends to concentrate its initial efforts in the development of non-opioid and non-narcotic agents, which could then be developed as combination agents for the treatment of various pain conditions.

In July 2003, POZEN executed an option agreement with Nycomed for the exclusive license to lornoxicam for the U.S. and Canadian markets. Lornoxicam is a non-steroial anti-inflammatory drug with established safety and efficacy in markets outside the U.S. As a potent analgesic, lornoxicam, alone or in combination with other agents, can provide novel therapies for pain.

Financial Report

Selected Financial Data

The following selected financial data are derived from the financial statements of POZEN Inc., which have been audited by Ernst & Young LLP, independent auditors. The data should be read in conjunction with the financial statements, related notes, and other financial information included (incorporated by reference) herein.

For the Year Ended December 31, (in thousands, except per share data)	1999	2000	2001	2002	2003	Period from September 26, 1996 (inception) through December 31, 2003
Statement of Operations Data:						
Revenue:						
Licensing revenue	$ –	$ –	$ –	$ –	**$ 3,717**	**$ 3,717**
Operating expenses:						
General and administrative	2,320	4,822	6,455	6,833	**9,211**	**32,227**
Research and development	9,458	19,399	18,627	18,762	**9,904**	**86,841**
Total operating expenses	11,778	24,221	25,082	25,595	**19,115**	**119,068**
Interest income (expense), net	(367)	1,844	3,380	1,040	**535**	**7,066**
Net loss	(12,145)	(22,377)	(21,702)	(24,555)	**(14,863)**	**(108,285)**
Non-cash preferred stock charge	–	27,617	–	–	**–**	**27,617**
Preferred stock dividends	–	934	–	–	**–**	**934**
Common stock dividends	–	–	–	–	**–**	**–**
Net loss attributable to common stockholders	$ (12,145)	$ (50,928)	$ (21,702)	$ (24,555)	**$ (14,863)**	**$ (136,836)**
Basic and diluted net loss per common share	$ (2.08)	$ (4.95)	$ (0.78)	$ (0.87)	**$ (0.52)**	
Shares used in computing basic and diluted net loss per common share	5,845	10,294	27,955	28,110	**28,414**	
Pro forma net loss per common share - basic and diluted*	$ (1.01)	$ (2.56)				
Pro forma weighted average common shares outstanding - basic and diluted*	12,018	19,915				

For the Year Ended December 31,	1999	2000	2001	2002	2003
Balance Sheet Data:					
Cash and cash equivalents	$ 4,171	$ 92,351	$ 73,959	$ 50,056	**$ 60,481**
Total assets	4,325	92,830	74,144	51,035	**61,513**
Total liabilities	2,360	3,762	3,523	1,836	**25,883**
Accumulated deficit	(24,787)	(48,099)	(69,801)	(94,356)	**(109,219)**
Total stockholders' equity	1,965	89,068	70,621	49,199	**35,630**

**Assumes conversion of all outstanding preferred stock into common stock as of the date of the original issuance.*

OVERVIEW

We are a pharmaceutical company committed to developing therapeutic advancements for diseases with unmet medical needs where we can improve efficacy, safety and/or patient convenience. Since our inception, our business activities have been associated primarily with the development of pharmaceutical product candidates for the treatment of migraine. We have developed what we believe to be one of the largest and most advanced product pipelines in the field of migraine. We have development and commercialization collaboration agreements relating to our migraine product candidates with GSK, Xcel and Nycomed. We are also exploring the development of product candidates in other pain-related therapeutic areas.

Since inception, our business activities have included:

- product candidate research and development;
- designing and funding clinical trials for our product candidates;
- regulatory and clinical affairs;
- intellectual property prosecution and expansion; and
- business development, including product acquisition and/or licensing and collaboration activities.

We have financed our operations and internal growth primarily through private placements of preferred stock, our initial public offering and, beginning in 2003, collaborations. Beginning in the third quarter of 2003, we began recognizing revenue from initial payments received under our collaboration agreements.

We have incurred significant losses since our inception and have not generated any revenue from product sales. As of December 31, 2003, our accumulated deficit was $109.2 million. Our historical operating losses have resulted principally from our research and development activities, including Phase 3 clinical trial activities for our product candidates MT 100 and MT 300, Phase 2 clinical trial activities for our MT 400 technology, which includes Trexima, and general and administrative expenses. Research and development expenses include salaries and benefits for personnel involved in our research activities and direct product costs, which include costs relating to the formulation and manufacturing of our product candidates, costs relating to preclinical studies, including toxicology studies, and clinical trials, and costs relating to compliance with regulatory requirements applicable to the development of our product candidates. Since inception, our research and development expenses have represented 73% of our total operating expenses. In the year ended December 31, 2003, our research and development expenses represented approximately 52% of our total operating expenses.

There follows a brief discussion of the status of the development of each of MT 100, MT 300 and Trexima as well the costs relating to our development activities.

- MT 100. We submitted applications for approvals of MT 100 to the FDA in July 2003 and to the UK in October 2002 and have submitted additional information in response to comments on our application submitted to the UK. We are not currently conducting any clinical trials for MT 100. However, we are continuing to incur pharmaceutical development costs for product stability testing and may incur costs for the commercialization of this product if our applications are approved by the FDA and MHRA. Until the FDA responds to our NDA for MT 100 and the MHRA responds to our submission of the additional data, however, we cannot reasonably estimate the nature and timing of additional costs that we may need to incur to satisfy comments on our applications for approval or when and to what extent we will receive cash inflows from MT 100.

  We have incurred direct product costs associated with the development of MT 100 during the fiscal years ended December 31, 2001, 2002 and 2003 and to date of $7.5 million, $4.0 million, $3.2 million and $38.0 million, respectively. Our direct product costs do not include the cost of research and development personnel or any allocation of our overhead expenses.

- MT 300. We submitted to the FDA an NDA for approval of MT 300 in December 2002. We are not currently conducting any clinical trials for MT 300. However, we are continuing to incur pharmaceutical development costs for product stability testing and may conduct additional Phase 3b marketing studies if our application is approved by the FDA. Until we complete our response to the not-approvable letter for MT 300 that we received from the FDA in October 2003 and the FDA responds to our completed response, we cannot reasonably estimate the nature and timing of additional costs that we may need to incur to satisfy comments on our application for approval or when and to what extent we will receive cash inflows from MT 300.

  We have incurred direct product costs associated with the development of MT 300 during the fiscal years ended December 31, 2001, 2002 and 2003 and to date of $3.0 million, $5.2 million, $0.8 million and $14.2 million, respectively. Our direct product costs do not include the cost of research and development personnel or any allocation of our overhead expenses.

- Trexima. We have commenced the Phase 3 clinical program for Trexima in May 2004. We cannot reasonably estimate or know the nature, timing and likely costs necessary to complete the development of Trexima or when and to what extent we will receive cash inflows from Trexima because of the uncertainty as to the scope and cost of clinical trials and other research and development activities and the cost and timing of regulatory approvals. However, we do expect to receive a milestone payment from GSK upon the commencement of Phase 3 clinical trials for Trexima in 2004, and, if we submit an NDA to the FDA for Trexima, we expect to receive milestone payments from GSK upon the FDA's acceptance of the NDA, and any approval of the NDA.

We have incurred direct product costs associated with the development of our MT 400 technology, which includes Trexima, during the fiscal years ended December 31, 2001, 2002 and 2003 and to date of $1.9 million, $4.7 million, $0.9 million and $8.1 million, respectively. Our direct product costs do not include the cost of research and development personnel or any allocation of our overhead expenses.

We expect to continue to incur operating losses over the next several years as we complete the development and application for regulatory approval of MT 100, Trexima and MT 300, develop other product candidates and acquire and develop product portfolios in other therapeutic areas. Our results may vary depending on many factors, including:

- the progress of MT 100, Trexima and MT 300 in the clinical and regulatory process;
- the establishment of collaborations for the development and commercialization of any of our product candidates; and
- the acquisition and/or in-licensing, and development, of other therapeutic product candidates.

Our ability to generate revenue is dependent upon our ability, alone or with others, to achieve the milestones set forth in our collaboration agreements and successfully develop our migraine and other product candidates, obtain regulatory approvals and successfully manufacture and market our future products. We have entered into three collaborations relating to our migraine product candidates to date.

Under the terms of our licensing agreement with Nycomed, we are eligible to receive milestone payments totaling up to $1.0 million upon the occurrence of certain regulatory approvals. Upon certain timeframes and conditions, Nycomed is obligated also to pay us a specified royalty on all sales of MT 100, based upon the higher of an agreed percentage of sales subject to certain reductions, or an agreed amount per unit sold subject to reduction under certain conditions. The licensing agreement will expire on a country-by-country basis upon the later of (a) the date of expiration of all royalty obligations in a particular country and (b) 15 years after the date of first commercial sale of MT 100 in such country under the agreement. Nycomed has the right to terminate the agreement if we default under the agreement or the MAA is not approved by a specified date or is withdrawn and can terminate the applicability of the agreement to a particular country if we withdraw the required regulatory application in such country.

Under the terms of our agreement with GSK, GSK is obligated to make milestone payments over the next several years in an amount up to $55.0 million upon achievement of specified development and regulatory milestones related to the first product developed under the agreement, including the commencement of Phase 3 trials and FDA specified actions relating to an NDA. GSK will also pay us royalties on all sales of the first marketed product, and in addition, potential sales performance milestones of up to $80.0 million if certain sales thresholds are achieved. There are also milestone and royalty payments associated with products developed subsequent to the first product. GSK may reduce, but not eliminate, the royalty payable to us if generic competitors attain a predetermined share of the market for the product, or if GSK owes a royalty to one or more third parties for rights it licenses from such third parties to commercialize the product. The agreement terminates on the date of expiration of all royalty obligations unless earlier terminated by either party for a material breach or by GSK at any time upon ninety (90) days written notice to us for any reason or no reason. In addition, we have certain rights to terminate the agreement.

Under the terms of our agreement with Xcel, potential milestone payments of up to $8.0 million will be due upon certain future regulatory approvals and the achievement of a predetermined sales threshold on MT 300. Xcel is also obligated to pay us royalties on all combined sales of MT 300 and Xcel's D.H.E. 45® (dihydroergotamine mesylate) Injection, once MT 300 is commercialized, subject to reduction in certain cases, or in the event that Xcel pays royalties to one or more third parties to license rights from such third parties to commercialize MT 300. The agreement terminates on the date of expiration of all royalty obligations unless earlier terminated by either party for a material breach or in certain other circumstances. Under certain circumstances, the agreement provides for the terminating party to facilitate the assumption of its responsibilities by the non-terminating party.

In October 2000, we received $78,265,552 in net proceeds from the sale of 5,750,000 shares of our common stock in our initial public offering, including the exercise of the underwriters' over-allotment option. All of our outstanding preferred shares were converted into shares of our common stock upon the completion of our initial public offering.

CRITICAL ACCOUNTING POLICIES

Management makes certain judgments and uses certain estimates and assumptions when applying accounting principles generally accepted in the United States in the preparation of our financial statements. The development and selection of the critical accounting policies, and the related disclosure about these policies, have been reviewed by the Audit Committee of the Board of Directors. We evaluate our estimates and judgments on an on-going basis and base our estimates on historical experience and on assumptions that we believe to be reasonable under the circumstances. Our experience and assumptions form the basis for our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may vary from what we anticipate and different assumptions or estimates about the future could change our reported results. While our significant accounting policies are more fully described in Note 1 to our financial statements, we believe the following accounting policies are the most critical to us, in that they are important to the portrayal of our financial statements and require our most difficult, subjective or complex judgments in the preparation of our financial statements.

Revenue Recognition

Our licensing and other collaborative agreements have terms that include up-front payments upon contract signing, additional payments if and when certain milestones in the product's development are reached, and royalty payments based on future product sales. We recognize revenue under these agreements in accordance with SEC Staff Accounting Bulletin 101, "Revenue Recognition" as amended by SAB 104 "Revenue Recognition", ("SAB 101"), and Emerging Issues Task Force 00-21 ("EITF 00-21"), "Revenue Arrangements with Multiple Deliverables".

Under SAB 101 recognition of revenue from non-refundable up-front payments is deferred by the Company upon receipt and recognized over the period ending on the anticipated dates of regulatory approvals, as specified in the agreements relating to the product candidates.

We recognize milestone payments as revenue upon the achievement of specified milestones if (i) the milestone is substantive in nature and the achievement of the milestone was not reasonably assured at the inception of the agreement and (ii) if the fees are non-refundable. Any milestone payments received prior to satisfying these revenue recognition criteria will be recorded as deferred revenue.

Royalty revenue will be recognized related to the manufacture, sale or use of the Company's products or technology. For those arrangements where royalties are reasonably estimable, the Company will recognize revenue based on estimates of royalties earned during the applicable period and adjust for differences between the estimated and actual royalties in the following period. For those arrangements where royalties are not reasonably estimable, the Company will recognize revenue upon receipt of royalty statements from the licensee.

Management believes that its current assumptions and other considerations used to estimate the periods for revenue recognition described above are appropriate. However, we continually review these estimates which could result in a change in the deferral period and might impact the timing and amount of revenue recognition. Further, if regulatory approvals relating to MT 100, MT 300 or Trexima are accelerated, delayed or not ultimately obtained, then the amortization of revenues for these products would prospectively be accelerated or reduced accordingly.

As of December 31, 2003, we had deferred $23.8 million of revenue. Thus far, we have recognized $3.7 million of revenue relating to our collaboration agreements.

Accrued Expenses, Including Contracted Costs

Significant management judgments and estimates must be made and used in connection with accrued expenses, including those related to contract costs, such as costs associates with our clinical trials. Specifically, our management must make estimates of costs incurred to date but not yet invoiced in relation to contracted, external costs. Management analyzes the progress of product development, clinical trial and toxicology and related activities, invoices received and budgeted costs when evaluating the adequacy of the accrued liability for these related costs. Material differences may result in the amount and timing of the accrued liability for any period if management made different judgments or utilized different estimates.

Management believes that its current assumptions and other considerations used to estimate accrued expenses for the period are appropriate. However, determining the date on which certain contract services commence, the level of services performed on or before a given date and the cost of such services often involves subjective judgments. In the event that we do not identify certain costs which have begun to be incurred or we under- or over-estimate the level of services performed or the costs of such services, our reported accrued expenses for such period would be too low or too high, as the case may be.

In the years ended December 31, 2003, 2002 and 2001, we recognized $836,000, $635,000 and $2,000,349, respectively, for accrued costs related to product development activities, including clinical trials, based upon the progress of the activities covered by the related contracts, invoices received and budgeted costs. These estimates have been reasonably accurate in the past. Based upon this experience, we believe that our estimates are not likely to change significantly in the future.

Income Taxes

We record deferred tax assets and liabilities based on the net tax effects of tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we establish a 2003 valuation allowance. We have not recorded any tax provision or benefit for the years ended December 31, 2003, 2002, or 2001. Since we are unable to conclude whether we will realize any future benefit from deductible temporary differences and net operating loss carry-forwards of approximately $69.0 million for federal and state income tax purposes, which are available to offset future federal and state taxable income, if any, and expire between 2011 and 2022, we have provided a valuation allowance for the full amount of our net deferred tax assets. We also have research and development tax credit carry-forwards of approximately $5.5 million for federal income tax reporting purposes which are available to reduce federal income taxes, if any, and expire between 2012 and 2022. The Tax Reform Act of 1986, the Act, provides for a limitation on the annual use of NOL and research and development tax credit carry-forwards (following certain ownership changes, as defined by the Act) that could significantly limit our ability to utilize these carry-forwards. We have experienced various ownership changes, as defined by the Act, as a result of past financings. Accordingly, our ability to utilize the aforementioned carry-forwards may be limited. If results of operations in the future indicate that some or all of the deferred tax assets will be recovered, the reduction of the valuation allowance will be recorded as a tax benefit during one or more periods.

HISTORICAL RESULTS OF OPERATIONS

Year Ended December 31, 2003 Compared To Year Ended December 31, 2002

Revenue: We recognized $3,717,000 of licensing revenue for the year ended December 31, 2003 as compared to no revenue for the year ended December 31, 2002. Revenue resulted from initial payments we received pursuant to development and commercialization agreements for MT 100, MT 300 and Trexima. These agreements have terms that include up-front payments upon contract signing and additional payments if and when certain milestones in the product development or related milestones are reached. All up-front payments are being deferred and amortized over the periods ending on the anticipated dates of regulatory approvals, as specified in the agreements relating to the product candidates.

Research and development: Research and development expenses decreased by 47% to $9,904,000 for the year ended December 31, 2003 as compared to the year ended December 31, 2002. The $8,858,000 decrease was due primarily to a decrease in direct product costs for MT 300 and MT 400 technology, including Trexima.

Direct product costs associated with the development of MT 300 decreased by $4,399,000 to $816,000 primarily due to completion of Phase 3 clinical trial activities and submission of a NDA to the FDA in 2002, as compared to 2003. Direct product costs associated with the development of MT 400 technology, which includes Trexima, decreased by $3,762,000 to $950,000 primarily due to a reduction in pharmaceutical development activities, including costs incurred in obtaining drug substance, and reduced costs associated with toxicology activities, as compared to the same period of 2002. Additional research and development expenses, including costs associated with lornoxicam product development, other exploratory development, and departmental expenses, increased by $444,000 to $4,930,000. The amortization of deferred stock compensation decreased by $1,141,000. Total amortization of deferred stock compensation included in research and development expenses was $141,000 and $1,282,000 for the years ended December 31, 2003 and 2002, respectively. We expect that research and development expenses will increase in 2004 due to the initiation of Phase 3 clinical trial activities for Trexima and continued development of lornoxicam and other exploratory research programs. We have included in our research and development expenses the personnel costs associated with our research activities and costs associated with pharmaceutical development, clinical trial and toxicology activities and regulatory matters.

General and administrative: General and administrative expenses increased by 35% to $9,211,000 for the year ended December 31, 2003 as compared to the year ended December 31, 2002. The $2,378,000 increase was due primarily to increased costs associated with administrative, business development and public company activities. The cost of administrative activities increased by $1,433,000, primarily due to a $1.0 million compensation payment to our chief executive officer pursuant to a performance-based award issued under POZEN's 2001 Long Term Incentive Plan. Business development activities increased by $1,358,000 due to pre-marketing activities for MT 100 and MT 300, and consulting fees associated with the licensing of our products. Public company activities increased by $900,000 due to an increase in legal and auditing fees and an increase in director liability insurance and director compensation. Other departmental expense decreased by $1,313,000 primarily due to a $1,257,000 decrease in the amortization of deferred stock compensation. Total amortization of deferred stock compensation included in general and administrative expenses was $369,000 and $1,626,000 for 2003 and 2002, respectively. General and administrative expenses consisted primarily of the costs of administrative personnel, facility infrastructure, business development and public company activities.

Interest income: Interest income decreased by 49% to $535,000 for the year ended December 31, 2003 as compared to the year ended December 31, 2002. Interest income decreased primarily due to a decline in interest rates during the year.

Year Ended December 31, 2002 Compared To Year Ended December 31, 2001

Revenue: We generated no revenue during the years ended December 31, 2002 and 2001.

Research and development: Research and development expenses increased 0.7% to $18,761,630 for the year ended December 31, 2002 as compared to $18,627,249 for the year ended December 31, 2001. The increase in expense was due to increased costs associated with direct product costs of MT 300 and MT 400 technology, which includes Trexima, offset by a decrease in development costs for MT 100 and termination of all development activities for MT 500. Direct product costs associated with the development of MT 300 increased by $2,149,000 to $5,215,000 primarily due to increased Phase 3 clinical trial activities in the second and third quarters of 2002 as compared to the same period of 2001 and direct costs associated with submission of an NDA to the FDA in December 2002. Direct product costs associated with the development of Trexima increased by $2,799,000 to $4,712,000, primarily due to a $1,311,000 increase in costs associated with obtaining drug substance, and a $1,018,000 increase in costs associated with toxicology activities, as compared to 2001. The increase in costs associated with obtaining drug substance was due to the purchase of drug substance for possible use in formulation development and the manufacturing of clinical trial supplies. The increase in costs related to toxicology activities was due to expenses incurred in connection with standard toxicology studies required by the FDA for inclusion in an NDA. Direct product costs associated with the development of MT 100 decreased by $3,490,000 to $4,020,000 due to a decrease in Phase 3 clinical trial activities during 2002, as compared to 2001. Direct product costs associated with the development of MT 500 decreased by $1,522,000 to $93,000. Direct product costs associated with all other product candidates increased by $87,000. Other research and development costs increased by $111,000. Total amortization of deferred stock compensation included in research and development expenses was $1,282,000 for 2002 as compared to $1,406,000 for 2001. We have included in our research and development expenses the personnel costs associated with our research activities and costs associated with product development, clinical trial and toxicology activities, and regulatory matters.

General and administrative: General and administrative expenses increased 5.8% to $6,833,336 for the year ended December 31, 2002 from $6,455,164 for the year ended December 31, 2001. The $378,000 increase was due to increased services and other costs associated with marketing, advertising and intellectual property consulting expenses associated with our business development activities that totaled $263,000, along with a $115,000 increase in other general operating expenses. Total amortization of deferred compensation included in general and administrative expenses was $1,626,000 for 2002 as compared to $1,740,000 for 2001. General and administrative expenses consisted primarily of the costs of administrative personnel, facility infrastructure, business development expenses and public company activities.

Interest income, net: Net interest income decreased to $1,040,056 for the year ended December 31, 2002 from $3,379,905 for the year ended December 31, 2001. Interest income declined primarily due to a decline in interest rates along with a decrease in levels of cash and cash equivalents available for investing during the year.

INCOME TAXES

As of December 31, 2003, we had available net operating loss carry-forwards of approximately $69.0 million for federal and state income tax purposes, which are available to offset future federal and state taxable income, if any, and expire between 2011 and 2022. We also have research and development tax credit carry-forwards of approximately $5.5 million for federal income tax reporting purposes which are available to reduce federal income taxes, if any, through 2022. Since our inception, we have incurred substantial losses and expect to incur substantial and recurring losses in future periods. The Tax Reform Act of 1986 (the Act) provides for a limitation on the annual use of net operating loss and research and development tax credit carry-forwards (following certain ownership changes, as defined by the Act) that could significantly limit our ability to utilize these carry-forwards. We have experienced various ownership changes, as defined by the Act, as a result of past financings. Accordingly, our ability to utilize the aforementioned carry-forwards may be limited. Additionally, because U.S. tax laws limit the time during which these carry forwards may be applied against future taxes, we may not be able to take full advantage of these carry-forwards for federal income tax purposes.

LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we have financed our operations and internal growth primarily through private placements of preferred stock and our initial public offering, resulting in aggregate net proceeds to us of $132,590,000. Additionally in 2003, we received $27.5 million in cash in upfront fees related to various collaboration agreements. At December 31, 2003, cash and cash equivalents totaled $60,481,000, an increase of $10,424,000 as compared to December 31, 2002. The increase in cash and cash equivalents resulted primarily from payments received under collaboration agreements offset by expenses associated with our operating activities.

Cash provided by operations of $9,678,000 during the year represented a net loss of $14,863,000 offset by non-cash charges of $640,000, an increase in prepaid and other assets of $145,000 and an increase in accounts payable and accruals of $24,046,000. The increase in accounts payable and accruals included $23,783,000 of deferred revenue and an increase in accrued expenses associated with our product development activities.

Cash used in investing activities of $38,000 during the year reflected the purchase of equipment.

Cash provided by financing activities during the year totaled $785,000, reflecting the net proceeds from the exercise of common stock options.

Barring unforeseen developments, we believe that our existing liquidity and capital resources, including the proceeds from our initial public offering and payments received under collaboration agreements, will be sufficient to complete planned product development activities reflected in the description of our business, and to satisfy our other currently anticipated cash needs for operating expenses for the next two years. We do not currently expect to make any material capital expenditures during the next two years. In addition, we do not currently have any milestone or other required material payment obligations during that period. However, regulatory delays in the development of our existing and future product candidates would increase our cash requirements beyond our current assumed needs and may require that we seek additional funds from sources that may not be available on terms favorable to us.

Further, any additional equity financing may be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants. Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary as a result of a number of factors. Our future capital requirements will depend on many factors, including:

- the number and progress of our clinical trials and other trials and studies;
- our ability to negotiate favorable terms with various contractors assisting in these trials and studies;
- our success in and manner of commercializing our products; and
- costs incurred to enforce and defend our patent claims and other intellectual rights.

We may issue shares of common stock in the future, including to fund additional unplanned development activities. On February 3, 2004, we filed with the Securities and Exchange Commission a shelf registration statement on Form S-3 under which we intend to register 8,540,000 shares of our common stock for sale in one or more public offerings.

OBLIGATIONS AND COMMITMENTS

The following summarizes our contractual obligations as of December 31, 2003, and the expected timing of maturities of those contractual obligations:

		Payments Due by Period			
Contractual Obligations	Total	2004	2005-2006	2007-2008	After 2008
Operating leases[1]	$ 2,407,000	$ 370,000	$ 763,000	$ 795,000	$ 479,000
Product development agreements[2]	$ 1,854,000	$ 1,803,000	$ 37,000	$ 14,000	–
Total contractual obligations	$ 4,261,000	$ 2,173,000	$ 800,000	$ 809,000	$ 479,000

1 These commitments are associated with operating leases. Payments due reflect fixed rent expense.

2 These amounts represent open purchase orders for ongoing pharmaceutical development activities for our product candidates. These commitments may be terminated by us at any time without incurring termination fees.

Management's Discussion and Analysis

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period ending after March 15, 2004. We did not have any ownership in any variable interest entities as of December 31, 2002 or December 31, 2003. We will apply the consolidation requirement of FIN 46 in future periods if we own any interest in any variable interest entity.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance could be accounted for as equity, be classified as liabilities in the statement of financial position. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. We do not expect the adoption of SFAS No. 150 to have a significant impact on our financial statements.

Quantitative and Qualitative Disclosures About Market Risk

Our proceeds from our initial public offering, private placements and collaboration agreements have been invested in money market funds that invest primarily in short-term, highly-rated investments, including U.S. Government securities, commercial paper and certificates of deposit guaranteed by banks. Under our current policies, we do not use interest rate derivative instruments to manage our exposure to interest rate changes. Because of the short-term maturities of our investments, we do not believe that a decrease in market rates would have a significant negative impact on the value of our investment portfolio. However, declines in interest rates reduced our interest income in 2003 as compared to the same period of 2002.

MARKET FOR THE COMPANY'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

(a) Market Price of and Dividends on the Registrant's Common Equity

The Company's common stock began trading on The Nasdaq National Market under the symbol "POZN" on October 11, 2000. As of February 1, 2004, we estimate that we had approximately 139 stockholders of record and approximately 3,290 beneficial holders of the common stock. The following table details the high and low sales prices for the common stock as reported by The Nasdaq National Market for the periods indicated.

	Price Range	
2002 Fiscal Year	High	Low
First Quarter	$ 6.69	$ 4.61
Second Quarter	$ 6.00	$ 3.95
Third Quarter	$ 5.62	$ 3.39
Fourth Quarter	$ 5.49	$ 4.30

	Price Range	
2003 Fiscal Year	High	Low
First Quarter	$ 5.19	$ 2.25
Second Quarter	$ 11.19	$ 3.71
Third Quarter	$ 19.40	$ 10.30
Fourth Quarter	$ 18.40	$ 9.74

On February 2, 2004, the closing price for our common stock as reported by The Nasdaq National Market was $14.56. We paid no cash dividends in 2003. We currently intend to retain all of our future earnings to finance the growth and development of our business and do not anticipate paying any cash dividends in the foreseeable future.

DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Our current directors and executive officers are as follows:

Name	Position
John R. Plachetka, Pharm.D.	Chairman, President and Chief Executive Officer
Kristina M. Adomonis	Senior Vice President, Business Development
W. James Alexander, M.D., M.P.H.,	Senior Vice President, Product Development
John E. Barnhardt	Vice President, Finance and Administration
Peter J. Wise, M.D. [3]	Director
James R. Butler [1]	Director
Arthur S. Kirsch [2]	Director
Kenneth B. Lee, Jr. [2]	Director
Paul J. Rizzo [1][2]	Director
Bruce A. Tomason [2][3]	Director
Ted G. Wood [3]	Director

(1) Member of the Nominating/Corporate Governance Committee of the Board of Directors
(2) Member of the Audit Committee of the Board of Directors
(3) Member of the Compensation Committee of the Board of Directors

Peter J. Wise, M.D., Vice Chairman, POZEN Inc.
James R. Butler, Former President, ALZA International
Arthur S. Kirsch, Managing Director, Vector Securities International, LLC
Kenneth B. Lee Jr., General Partner, Hatteras BioCapital, LLC
Paul J. Rizzo, Chairman of the Board and Partner, Franklin Street Partners
Bruce A. Tomason, Chief Executive Officer, Aterna, LLC
Ted G. Wood, Former Vice Chairman, The United Company

Report of Independent Auditors

The Board of Directors
POZEN Inc.

We have audited the accompanying balance sheets of POZEN Inc. (a development stage company) as of December 31, 2003 and 2002, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2003 and for the period from September 25, 1996 (inception) through December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of POZEN Inc. at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ending December 31, 2003 and for the period from September 25, 1996 (inception) through December 31, 2003, in conformity with accounting principles generally accepted in the United States.

Raleigh, North Carolina
January 16, 2004

Balance Sheets

For the Year Ended December 31,	2003	2002
Assets		
Current assets:		
Cash and cash equivalents	**$ 60,480,690**	$ 50,056,251
Prepaid expenses and other current assets	**698,209**	553,371
Total current assets	**61,178,899**	50,609,622
Equipment, net of accumulated depreciation	**334,096**	425,369
Total assets	**$ 61,512,995**	$ 51,034,991
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	**$ 579,903**	$ 179,374
Accrued expenses	**1,519,675**	1,657,074
Total current liabilities	**2,099,578**	1,836,448
Long-term liabilities:		
Deferred revenue	**23,782,978**	–
Total liabilities	**25,882,556**	1,836,448
Common stock, $0.001 par value, 90,000,000 shares authorized; 28,492,201 and 28,147,039 shares issued and outstanding at December 31, 2003 and December 31, 2002, respectively	**28,492**	28,147
Additional paid-in capital	**144,821,230**	144,036,491
Deferred compensation	**–**	(510,130)
Deficit accumulated during the development stage	**(109,219,283)**	(94,355,965)
Total stockholders' equity	**35,630,439**	49,198,543
Total liabilities and stockholders' equity	**$ 61,512,995**	$ 51,034,991

See accompanying Notes to Financial Statements.

Statements of Operations

For the Year Ended December 31,	2003	2002	2001	Period from September 26, 1996 (inception) through December 31, 2003
Revenue:				
Licensing revenue	**$ 3,717,000**	$ –	$ –	$ 3,717,000
Operating expenses:				
General and administrative	**9,211,341**	6,833,336	6,455,164	32,226,868
Research and development	**9,904,347**	18,761,630	18,627,249	86,841,229
Total operating expenses	**19,115,688**	25,594,966	25,082,413	119,068,097
Interest income	**535,370**	1,040,056	3,379,905	7,066,292
Net loss	**(14,863,318)**	(24,554,910)	(21,702,508)	(108,284,805)
Non-cash preferred stock charge	**–**	–	–	27,617,105
Preferred stock dividends	**–**	–	–	934,478
Loss attributable to common stockholders	**$ (14,863,318)**	$ (24,554,910)	$ (21,702,508)	$ (136,836,388)
Basic and diluted net loss per common share	**$ (0.52)**	$ (0.87)	$ (0.78)	
Shares used in computing basic and diluted net loss per common share	**28,329,339**	28,110,352	27,954,697	

See accompanying Notes to Financial Statements.

Statements of Cash Flows

For the Year Ended December 31,	2003	2002	2001	Period from September 26, 1996 (inception) through December 31, 2003
Operating activities				
Net loss	**$ (14,863,318)**	$ (24,554,910)	$ (21,702,508)	$ (108,284,805)
Adjustments to reconcile net loss to net provided by cash (used in) operating activities:				
Depreciation	**129,560**	113,513	115,640	525,329
Loss on disposal of equipment	**–**	2,726	24,769	27,495
Amortization of deferred compensation	**510,130**	2,908,079	3,145,870	10,875,281
Noncash financing charge	**–**	–	–	450,000
Changes in operating assets and liabilities:				
Prepaid expenses and other current assets	**(144,838)**	(477,185)	244,209	(698,209)
Deferred revenue	**23,782,978**	–	–	23,782,978
Net cash provided by (used in) operating activities	**9,677,642**	(23,694,348)	(18,410,861)	(71,222,353)
Investment activities				
Purchase of equipment	**(38,287)**	(432,594)	(90,643)	(886,920)
Net cash used in investing activities	**(38,287)**	(432,594)	(90,643)	(886,920)
Financing activities				
Proceeds from issuance of preferred stock	**–**	–	–	48,651,850
Proceeds from issuance of common stock	**785,084**	224,469	109,645	80,096,098
Proceeds from stockholders' receivables	**–**	–	–	1,004,310
Proceeds from notes payable	**–**	–	–	3,000,000
Payment of dividend	**–**	–	–	(162,295)
Net cash provided by financing activities	**785,084**	224,469	109,645	132,589,963
Net increase (decrease) in cash and cash equivalents	**10,424,439**	(23,902,473)	(18,391,859)	60,480,690
Cash and cash equivalents at beginning of period	**50,056,251**	73,958,724	92,350,583	–
Cash and cash equivalents at end of period	**$ 60,480,690**	$ 50,056,251	$ 73,958,724	$ 60,480,690
Supplemental schedule of cash flow information				
Cash paid for interest	**$ 538**	$ 2,106	$ 2,162	$ 191,328
Supplemental schedule of noncash investing and financing activities				
Conversion of notes payable to preferred stock	**$ –**	$ –	$ –	$ 3,000,000
Preferred stock dividend	**$ –**	$ –	$ –	$ 772,183
Forfeiture of common stock options and warrants	**$ –**	$ 272,166	$ 42,213	$ 314,179
Conversion of common stock warrants to common stock	**$ –**	$ 49,809	$ 115,240	$ 1,080,001

See accompanying Notes to Financial Statements.

Statements of Stockholders Equity

	Preferred Stock	Common Stock	Additional Paid-In Capital	Common Stock Warrants
Issuance of common stock	$ –	$ 5,814	$ (1,504)	$ –
Issuance of preferred stock	2,106	–	6,231,314	–
Issuance of preferred stock warrants	–	–	–	242,000
Deferred compensation	–	–	190,385	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 1996	2,106	5,814	6,420,195	242,000
Proceeds from stockholders' receivable	–	–	–	–
Issuance of preferred stock	1,135	–	4,195,865	–
Issuance of preferred stock warrants	–	–	–	139,000
Deferred compensation	–	–	1,001,629	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 1997	3,241	5,814	11,617,689	381,000
Issuance of preferred stock	567	–	2,187,758	–
Issuance of preferred stock warrants	–	–	–	35,000
Exercise of common stock options	–	30	5,525	–
Deferred compensation	–	–	362,489	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 1998	3,808	5,844	14,173,461	416,000
Issuance of preferred stock	2,594	–	11,522,406	–
Issuance of preferred stock warrants	–	–	–	925,000
Exercise of common stock options	–	4	621	–
Deferred compensation	–	–	3,045,666	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 1999	6,402	5,848	28,742,154	1,341,000
Proceed from sale of common stock	–	750	10,461,750	–
Proceeds from sale of common stock in IPO,net of offering costs	–	5,000	67,798,052	–
Conversion of preferred stock to common stock	(6,402)	15,488	27,347,019	–
Exercise of common stock options	–	208	74,861	–
Exercise of common stock warrants	–	369	1,805,682	(914,952)
Preferred stock dividend	–	–	–	–
Dividends	–	69	772,114	–
Deferred compensation	–	–	6,328,492	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 2000	–	27,732	143,330,124	426,048
Exercise of common stock options	–	187	109,408	–
Exercise of common stock warrants	–	50	115,240	(115,240)
Forfeiture of common stock options	–	–	(42,213)	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 2001	–	27,969	143,512,559	310,808
Exercise of common stock options	–	159	224,291	–
Exercise and forfeiture of common stock warrants	–	19	310,808	(310,808)
Forfeiture of common stock options	–	–	(11,167)	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 2002	–	28,147	144,036,491	–
Exercise of common stock options	–	345	784,739	–
Amortization of deferred compensation	–	–	–	–
Net Loss	–	–	–	–
Balance at December 31, 2003	**$ –**	**$ 28,492**	**$ 144,821,230**	**$ –**

See accompanying Notes to Financial Statements.

Receivable From Stockholders	Deferred Compensation	Accumulated Deficit	Total Stockholders' Equity
$ (4,310)	$ –	$ –	$ –
(1,000,000)	–	–	5,233,420
–	–	–	242,000
–	(190,385)	–	–
–	28,267	–	28,267
–	–	(101,334)	(101,334)
(1,004,310)	(162,118)	(101,334)	5,402,353
1,004,310	–	–	1,004,310
–	–	–	4,197,000
–	–	–	139,000
–	(1,001,629)	–	–
–	214,272	–	214,272
–	–	(3,803,030)	(3,803,030)
–	(949,475)	(3,904,364)	7,153,905
–	–	–	2,188,325
–	–	–	35,000
–	–	–	5,555
–	(362,489)	–	–
–	401,468	–	401,468
–	–	(8,737,631)	(8,737,631)
–	(910,496)	(12,641,995)	1,046,622
–	–	–	11,525,000
–	–	–	925,000
–	–	–	625
–	(3,045,666)	–	–
–	612,909	–	612,909
–	–	(12,145,446)	(12,145,446)
–	(3,343,253)	(24,787,441)	1,964,710
–	–	–	10,462,500
–	–	–	67,803,052
–	–	–	27,356,105
–	–	–	75,069
–	–	–	891,099
–	–	(934,478)	(934,478)
–	–	–	772,183
–	(6,328,492)	–	–
–	3,054,286	–	3,054,286
–	–	(22,376,628)	(22,376,628)
–	(6,617,459)	(48,098,547)	89,067,898
–	–	–	109,595
–	–	–	50
–	42,213	–	–
–	3,145,870	–	3,145,870
–	–	(21,702,508)	(21,702,508)
–	(3,429,376)	(69,801,055)	70,620,905
–	–	–	224,450
–	–	–	19
–	11,167	–	–
–	2,908,079	–	2,908,079
–	–	(24,554,910)	(24,554,910)
–	(510,130)	(94,355,965)	49,198,543
–	–	–	785,084
–	510,130	–	510,130
–	–	(14,863,318)	(14,863,318)
$ –	**$ –**	**$ (109,219,283)**	**$ 35,630,439**

Notes to Consolidated Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

Development Stage Company

POZEN Inc. ("POZEN" or the "Company") was incorporated in the state of Delaware on September 25, 1996. The Company is a pharmaceutical company committed to developing therapeutic advancements for diseases with unmet medical needs where the Company can improve efficacy, safety and/or patient convenience. Since the Company's inception, it has developed what it believes to be one of the largest and most advanced product pipelines in the field of migraine. The Company is also exploring the development of product candidates in other pain-related therapeutic areas.

The Company currently has three product candidates in the migraine area. MT 100, a combination of metoclopramide hydrochloride and naproxen sodium, is being developed as an oral, first-line treatment for migraine pain and associated symptoms. The Company has completed all planned Phase 3 pivotal clinical trials for MT 100, which consistently demonstrated MT 100's effectiveness in treating migraine pain. In July 2003, the Company submitted a New Drug Application ("NDA") to the U.S. Food and Drug Administration ("FDA") for MT 100. The NDA was accepted for filing by the FDA in October 2003. On January 27, 2004, the Company submitted to the FDA the report of the results of a two-year rat carcinogenicity study, thereby completing our NDA submission. The Company expects the FDA to complete its review of the NDA by May 31, 2004. In October 2002, the Company submitted a Marketing Authorization Application ("MAA") for MT 100 to the Medicines and Healthcare Products Regulatory Agency ("MHRA") in the United Kingdom ("UK"). In September 2003, the Company received a letter of comments relating to the MAA from an advisory group to the MHRA. POZEN intends to submit a response to the comments raised by the advisory group during the first quarter of 2004.

POZEN's MT 400 technology, which includes Trexima, is being developed as a co-active acute migraine therapy, combining the activity of a triptan with that of a long-lasting non-steroidal anti-inflammatory drug ("NSAID"). In June 2003, the Company signed an agreement with GlaxoSmithKline ("GSK") for the development and commercialization of proprietary combinations of a triptan (5-$HT_{1B/1D}$ agonist) and a long-acting NSAID. The combinations covered by the agreement are among the combinations of MT 400 technology. The Company plans to commence Phase 3 clinical trials in 2004.

MT 300, a proprietary formulation of injectable dihydroergotamine mesylate ("DHE") in a pre-filled syringe, is being developed to provide long-lasting pain relief for patients needing a convenient injectable therapy for severe migraine attacks. In September 2003, the Company signed an agreement with Xcel Pharmaceuticals Inc. ("Xcel") for the further development and commercialization of MT 300. In October 2003, the Company received a not-approvable letter from the FDA related to its MT 300 NDA. The Company is working with the FDA to seek to resolve the issues raised in the letter as soon as possible.

The Company plans to enter into collaborations with established pharmaceutical or pharmaceutical services companies to commercialize and manufacture its product candidates. In addition to the collaborations mentioned above, to date, the Company has also entered into a collaboration with Nycomed Danmark ApS ("Nycomed") relating to MT 100. The Company may also elect in certain circumstances to develop sales and distribution capabilities internally to commercialize one or more of its product candidates.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from the estimates and assumptions used.

Revenue Recognition

The Company's licensing agreements have terms that include up-front payments upon contract signing, additional payments if and when certain milestones in the product's development or commercialization are reached, and royalty payments based on future product sales. These agreements are accounted for in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition", as amended by SAB 104, "Revenue Recognition" ("SAB 101"), and Emerging Issues Task Force 00-21 ("EITF 00-21"), "Revenue Arrangements with Multiple Deliverables."

Revenue from non-refundable up-front payments is deferred by the Company upon receipt and recognized over the period ending on the anticipated date of regulatory approvals, as specified in the agreements relating to the product candidates.

Milestone payments are recognized as revenue upon the achievement of specified milestones if (i) the milestone is substantive in nature and the achievement of the milestone was not reasonably assured at the inception of the agreement and (ii) the fees are non-refundable. Any milestone payments received prior to satisfying these revenue recognition criteria are recorded as deferred revenue.

Royalty revenue will be recognized with respect to the manufacture, sale or use of the Company's products or technology. For those arrangements where royalties are reasonably estimable, the Company will recognize revenue based on estimates of royalties earned during the applicable period and adjust for differences between the estimated and actual royalties in the following period. For those arrangements where royalties are not reasonably estimable, the Company will recognize revenue upon receipt of royalty statements from the licensee.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash is invested in interest-bearing investment-grade securities.

Cash and cash equivalents include financial instruments that potentially subject the Company to a concentration of credit risk. Cash and cash equivalents are deposited with high credit quality financial institutions which invest primarily in U.S. Government securities, highly rated commercial paper and certificates of deposit guaranteed by banks which are members of the FDIC. The counterparties to the agreements

relating to the Company's investments consist primarily of the U.S. Government and various major corporations with high credit standings.

Equipment

Equipment consists primarily of furniture and fixtures and is recorded at cost. Depreciation is computed using the Modified Accelerated Cost Recovery System (MACRS) over the estimated useful lives of the assets ranging from five to seven years.

Research and Development Costs

Research and development costs are charged to operations as incurred.

Income Taxes

The Company accounts for income taxes using the liability method. Deferred income taxes are provided for temporary differences between financial reporting and tax bases of assets and liabilities.

Net Loss Per Share

Basic and diluted net loss per common share amounts are presented in conformity with Statement of Financial Accounting Standards No. ("SFAS") 128, "Earnings per Share." In accordance with SFAS 128, basic and diluted net loss per common share amounts have been computed using the weighted-average number of shares of common stock outstanding for the years ended December 31, 2003, 2002 and 2001.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents and accounts payable. The carrying values of cash and cash equivalents and accounts payable approximate the fair value due to the short-term nature of such instruments.

Patent Costs

The Company expenses patent costs, including legal expenses, in the period in which they are incurred. Patent expenses are included in general and administrative expenses in the Company's statements of operations.

Comprehensive Loss

The Company has adopted the provisions of SFAS No. 130, "Comprehensive Income." SFAS 130 establishes standards for the reporting and display of comprehensive income and its components for general purpose financial statements. For all periods presented, there were no differences between net loss and comprehensive loss.

Stock-Based Compensation

Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB No. 25"), and its related interpretations are applied to measure compensation expense for stock-based compensation plans. The Company complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended by SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure. Under APB No. 25, unearned stock compensation is based on the difference, if any, on the date of grant, between the fair value of the Company's common stock and the exercise price. See Note 7 for a description of the plans and assumptions underlying the pro forma calculations below.

In connection with the grant of stock options to employees, the Company recorded no deferred compensation in the twelve months ended December 31, 2003. Deferred compensation recognized in prior periods was recorded as a component of stockholders' equity and is being amortized as charges to operations over the vesting period of the options using the straight-line method. The vesting period of the options is generally three or four years. The Company recorded amortization of deferred compensation of $510,000, $2,908,000 and $3,146,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

For the Year Ended December 31,	2003	2002	2001
Net loss attributed to common stockholders as reported	**$ (14,863,318)**	$ (24,554,910)	$ (21,702,508)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	**510,130**	2,908,079	3,145,870
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all awards, net of related tax effects	**(3,338,823)**	(5,716,748)	(4,204,958)
Pro forma net loss attributed to common stockholders	**$ (17,692,011)**	$ (27,363,579)	$ (22,761,596)
Earnings per share			
Net loss per common share as reported – basic and diluted	**$ (0.52)**	$ (0.87)	$ (0.78)
Net loss per common share pro forma – basic and diluted	**$ (0.62)**	$ (0.97)	$ (0.81)
Weighted-average shares used in computing basic and diluted net loss per common share	**28,329,339**	28,110,352	27,954,697

Recently Issued Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 ("FIN 46") requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period ended after March 15, 2004. The Company did not have any ownership in any variable interest entities as of December 31, 2003. The Company will apply the consolidation requirement of FIN 46 in future periods if it owns an interest in any variable interest entity.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance could be accounted for as equity, be classified as liabilities in the statement of financial position. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. The Company does not expect the adoption of SFAS No. 150 to have a significant impact on its financial statements.

2. LICENSE AGREEMENTS

The Company has entered into various license agreements to further develop, sell and manufacture its product candidates.

In June 2003, the Company entered into an agreement with Nycomed for MT 100. The Company received an upfront licensing fee from Nycomed of $500,000. The non-refundable portion of the payment has been deferred and is being amortized over the 30 months beginning in July 2003 and ending in December 2005, representing the anticipated period during which marketing approval will be sought in the four Nordic countries covered under the agreement. Upon the approval in the UK of the Company's MAA, the remaining portion of the payment, deferred upon receipt, will be amortized through December 2005. Potential milestone payments totaling $1.0 million will be due upon the occurrence of certain regulatory approvals. In addition, Nycomed will pay a royalty on sales of MT 100.

In June 2003, the Company entered into an agreement with GSK for certain triptan combinations developed using the Trexima technology. The Company received from GSK non-refundable initial licensing and patent-issuance milestone payments totaling $25.0 million. Recognition of this revenue has been deferred and is being amortized over 42 months beginning in July 2003. The 42 months represent the anticipated period during which the Company will be engaged in research and development and the regulatory submission and approval process for the MT 400 technology. Potential milestone payments totaling up to $55.0 million will be due relating to Trexima development progress, regulatory submissions and approvals. GSK will also pay the Company royalties on sales of marketed products as well as potential sales performance milestones of up to $80.0 million, if certain sales thresholds are achieved.

In September 2003, the Company entered into an agreement with Xcel for MT 300. The Company received a non-refundable upfront licensing fee from Xcel of $2.0 million for development and commercialization rights of MT 300. Under certain circumstances, if the Company elects not to seek approval of the NDA for MT 300, it would be required to pay to Xcel a termination fee of $1.0 million. As a result of the receipt of a not-approvable letter from the FDA related to its MT 300 NDA, $1.0 million has been deferred and will be amortized over 32 months, beginning in September 2003 and ending in April 2006. The 32 months represents the period during which the Company expects to be engaged in efforts relating to the regulatory submission for related approvals of MT 300 and further research and development. Upon the FDA approval of MT 300, the remaining $1.0 million of the upfront payment, deferred upon receipt, will be amortized through April 2006. Potential milestone payments totaling up to $8.0 million will be due upon certain future regulatory approvals and upon the achievement of a predetermined MT 300 sales threshold. Xcel will also pay a royalty on the combined sales of MT 300 and Xcel's D.H.E. 45® (dihydroergotamine mesylate) Injection.

Management believes current assumptions and other considerations used to estimate the period for revenue recognition are appropriate. However, if regulatory approvals relating to MT 100, MT 300 or Trexima are accelerated, delayed or not ultimately obtained, then the amortization of revenues for these products will be accelerated or reduced accordingly.

3. STOCKHOLDERS' EQUITY

Prior to 2000, the Company completed five private placement offerings of preferred stock as shown in the table set forth below. In connection with four of these offerings, warrants were issued to certain key advisors for their services related to the offerings. The warrants have been exercised or have expired.

Year of Issuance	Series	Number of Shares Issued	$ Received (net of offering costs)	Number of Shares Underlying Warrants	Offering Costs Resulting From Warrants	Price at Issuance
1996	A Convertible Preferred	2,105,931	$ 6,475,420	78,776	$ 242,000	$ 3.15
1997	B Convertible Preferred	1,135,000	$ 4,336,000	36,450	$ 139,000	$ 4.00
1998	B Convertible Preferred	4,377	$ 17,512	–	$ –	$ 4.00
1998	C Convertible Preferred	563,044	$ 2,205,813	8,884	$ 35,000	$ 4.05
1999	D Convertible Preferred	2,593,750	$ 12,000,000	200,000	$ 925,000	$ 4.80

All outstanding shares of Series A, Series B, Series C and Series D and the related warrants were converted into 8,636,436 shares of the Company's common stock and warrants for 437,228 shares of the Company's common stock upon the closing of the Company's initial public offering in October 2000.

Shares Reserved for Future Issuance

At December 31, 2003, shares of common stock reserved for future issuance are as follows:

Shares available for grant under stock option plans	842,571
Shares issuable pursuant to options granted under stock option plans	2,643,302
Total reserved	3,485,873

4. REDEEMABLE PREFERRED STOCK

On March 24, 2000, the Company completed a private placement of 2,589,927 shares of Series E Convertible Preferred Stock ("Series E") and received cash of $16,875,115, net of offering costs. The Series E holders were entitled to receive cumulative dividends at an annual rate of 8% of the original purchase price payable in cash or shares of Series E at the option of the holder. Dividends were payable when declared by the Board of Directors and upon conversion, liquidation or redemption. The Series E was convertible at a price that decreased from $6.95 to $5.73 since the Company was unable to complete by September 15, 2000 a qualified public offering or to effect a merger or acquisition of the Company that would entitle the holders of the Series E to receive $10.43 or more per share. At the date of issuance, the Company believed the per share price of $6.95 represented the fair value of the preferred stock and was in excess of the deemed fair value of its common stock. Subsequent to the commencement of the Company's initial public offering process, the Company re-evaluated the deemed fair market value of its common stock as of March 2000 and determined it to be $22.48 per share (on a pre-split basis). Accordingly, the incremental fair value of the Series E was deemed to be the equivalent of a preferred stock dividend. The Company recorded the non-cash preferred stock charge at the date of issuance by offsetting charges and credits to additional paid-in capital of $16,875,115, without any effect on total stockholders' equity. The non-cash charge was limited to the net proceeds received from the Series E offering.

In conjunction with the issuance of the Series E, the Company issued warrants to purchase 24,485 shares of Series E at an initial exercise price of $6.95 per share to certain key advisors for their services related to the offering. The warrants have been accounted for as offering costs related to the issuance of Series E at a value calculated under the "Black Scholes" formula at approximately $261,000. During 2002, the warrants expired and the reduction of value of the warrants was recorded as additional paid-in capital.

On August 28, 2000, the Company completed a private placement of 1,597,285 shares of Series F Convertible Preferred Stock ("Series E") and received cash of $10,742,000, net of offering costs. The terms of the Series F are substantially similar to those of the Series E. The Company recorded a non-cash preferred stock charge at the date of issuance by offsetting charges and credits to additional paid-in capital of $10,742,000, without any effect on total stockholders' equity.

All outstanding shares of Series E and related Series E warrants and Series F were converted into 6,851,207 shares of the Company's common stock and warrants exercisable for 33,030 shares of the Company's common stock upon the closing of the Company's initial public offering in October 2000. The Series E warrants, value at $260,999, were forfeited in October 2002.

5. ACCRUED EXPENSES

Accrued expenses consist of the following at December 31:

	2003	2002
Research and development costs	**$ 836,355**	$ 634,831
Compensation costs	**416,053**	931,454
Other	**267,267**	90,789
	$ 1,519,675	$ 1,657,074

6. INCOME TAXES

At December 31, 2003 and 2002, the Company had federal and state net operating loss carryforwards of approximately $69,044,000 and $78,270,000, respectively, and research and development credit carryforwards of approximately $5,483,000 and $4,483,000, respectively. The federal and state net operating loss carryforwards begin to expire in 2011 and the research and development credit carryforwards begin to expire in 2012. For financial reporting purposes, a valuation allowance has been recognized to offset the deferred tax assets related to the carryforwards. When, and if recognized, the tax benefit for those items will be reflected in current operations of the period in which the benefit is recorded as a reduction of income tax expense. The utilization of the loss carryforwards to reduce future income taxes will depend on the Company's ability to generate sufficient taxable income prior to the expiration of the net operating loss carryforwards. In addition, the maximum annual use of net operating loss carryforwards is limited in certain situations where changes occur in stock ownership.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows at December 31:

	2003	2002
Deferred tax assets:		
Net operating loss carryforwards	**$ 27,532,000**	$ 31,197,000
Research and development credits	**5,483,000**	4,483,000
Revenue recognition	**9,071,000**	–
Depreciation	**23,000**	44,000
Other	**–**	2,000
Total deferred tax assets	**42,109,000**	35,726,000
Valuation allowance	**(42,109,000)**	(35,726,000)
Net deferred tax asset	**$ –**	$ –

The amount of the valuation allowance increased by $6,383,000 and $8,965,000 as of December 31, 2003 and 2002, respectively.

The actual income tax expense for the years ended December 31, 2003, 2002 and 2001, differed from the amounts computed by applying the U.S. federal tax rate of 35% to pretax earnings as a result of the following:

	2003	2002	2001
Loss before income tax	**$ (14,863,000)**	$ (24,555,000)	$ (21,703,000)
Federal tax rate	**35%**	35%	35%
Federal income tax provisions at statutory rate	**(5,202,000)**	(8,594,000)	(7,596,000)
State tax provision	**(590,000)**	(982,000)	(868,000)
Increase (decrease) in income tax expense resulting from:			
Research and development credits	**(646,000)**	(500,000)	(804,000)
Non-deductible expenses and other	**55,000**	1,111,000	609,000
Change in reserve	**6,383,000**	8,965,000	8,659,000
Tax expense	**$ –**	$ –	$ –

7. STOCK OPTION PLAN

On November 20, 1996, the Company established a Stock Option Plan and authorized the issuance of options for up to 1,605,310 shares of common stock to attract and retain quality employees and to allow such employees to participate in the growth of the Company. Awards may be made to participants in the form of incentive and nonqualified stock options. Eligible participants under the Plan include executive and key employees of the Company. The vesting periods range from immediate vesting at issuance to four years or immediately upon a significant change in ownership as defined by the plan document. The exercise price for incentive stock options may not be less than 100% of the fair market value of the common stock on the date of grant (110% with respect to incentive stock options granted to optionees who are holders of 10% or more of the Company's common stock).

In May 2000, the Board of Directors adopted, and in June 2000 the stockholders approved, the POZEN Inc. 2000 Equity Compensation Plan. The Plan became effective upon the completion of the Company's initial public offering in October 2000 and provides for grants of incentive stock options, nonqualified stock options, stock awards, performance units, and other stock-based awards to our employees, non-employee directors, advisors, and consultants. The Plan authorizes up to 3,000,000 shares of common stock for issuance under the terms of the Plan. The maximum number of shares for which any individual may receive grants in any calendar year is 1,000,000 shares. The vesting periods range from immediate vesting at issuance to four years or immediately upon a significant change in ownership as defined by the plan document. If options granted under the Plan expire or are terminated for any reason without being exercised, or if stock awards, performance units, or other stock-based awards are forfeited or otherwise terminate, the shares of common stock underlying the grants will again be available for purposes of the Plan.

A summary of the Company's stock option activity, and related information is as follows:

	Number of Shares	Weighted-Average Exercise Price
Balance at December 31, 1996	88,562	$ 0.19
Options granted	470,127	0.19
Forfeited	(10,118)	0.19
Balance at December 31, 1997	548,571	0.19
Options granted	194,593	0.33
Exercised	(29,977)	0.19
Forfeited	(104,923)	0.19
Balance at December 31, 1998	608,264	0.23
Options granted	612,221	1.12
Exercised	(3,373)	0.19
Forfeited	(105,222)	0.88
Balance at December 31, 1999	1,111,890	0.66
Options granted	486,762	2.87
Exercised	(208,334)	0.36
Forfeited	(6,745)	1.48
Balance at December 31, 2000	1,383,573	1.49
Options granted	808,591	9.45
Exercised	(187,837)	0.58
Forfeited	(8,545)	2.48
Balance at December 31, 2001	1,995,782	4.79
Options granted	697,453	5.08
Exercised	(158,987)	1.41
Forfeited	(105,452)	7.18
Balance at December 31, 2002	2,428,796	4.99
Options granted	954,792	7.01
Exercised	(345,162)	2.27
Forfeited	(395,124)	4.71
Balance at December 31, 2003	**2,643,302**	**$ 6.11**

The options outstanding and exercisable at December 31, 2003 are as follows:

Options Outstanding		Weighted-Average		
Exercise Price	Number Outstanding	Exercise Price	Remaining Contractual Life (In years)	Vested Options
$ 0.19 – $ 3.74	495,633	$ 1.03	3.4	495,633
$ 4.25 – $ 7.38	1,536,217	$ 5.38	8.3	447,344
$ 8.50 – $ 11.84	270,000	$ 10.39	8.5	72,500
$ 12.50 – $ 17.45	341,452	$ 13.43	7.9	117,976
	2,643,302	$ 6.11	7.6	2,317,407

The Company has elected to follow APB 25 and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under SFAS 123 requires use of option valuation models that were not developed for use in valuing employee stock options.

Pro forma net loss information is required to be disclosed by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair market value method of that statement. The fair value for these options was estimated at the date of grant using the minimum value method with the following weighted-average assumptions:

	2003	2002	2001	2000
Expected dividend yield	**0%**	0%	0%	0%
Risk-free interest rate range	**2.72% – 4.20%**	1.73% – 4.26%	3.5% – 5.0%	5.3% – 6.6%
Expected life	**10 years**	10 years	10 years	10 years
Expected volatility	**1.03-1.08**	1.08	1.38	0.00

8. LEASES

The Company leases its office space and certain equipment under cancelable and noncancelable operating lease agreements. Rent expense incurred by the Company was approximately $356,000, $230,000, $146,000, and $1,103,000 for the years ended December 31, 2003, 2002 and 2001 and for the period September 25, 1996 (inception) through December 31, 2003, respectively. The following is a schedule of future minimum lease payments for operating leases at December 31, 2003:

2004	$ 369,747
2005	377,486
2006	385,311
2007	393,418
Thereafter	880,868
	$ 2,406,830

9. RETIREMENT SAVINGS PLAN

In July 1997, the Company began a defined contribution 401(k) pension plan (the "Plan") covering substantially all employees who are at least 21 years of age. Based upon management's discretion, the Company may elect to make contributions to the Plan. For the year ended December 31, 2000, the Company did not make any contribution to the Plan. During the years ended December 31, 2003, 2002, and 2001, and for the period September 25, 1996 (inception) through December 31, 2003, the Company made contributions of $123,701, $118,718, $92,277 and $334,696, respectively, to the Plan.

Notes to Consolidated Financial Statements

10. SUMMARY OF OPERATIONS BY QUARTERS (UNAUDITED)

2003	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	**$ –**	**$ –**	**$ 1,886,998**	**$ 1,843,002**
Operating expenses	**4,976,015**	**4,803,996**	**5,747,273**	**3,588,404**
Net loss	**(4,832,746)**	**(4,680,704)**	**(3,731,966)**	**(1,617,902)**
Net loss per share of common stock				
Basic and diluted	**$ (0.17)**	**$ (0.17)**	**$ (0.13)**	**$ (0.05)**
Number of shares used in per share calculation				
Basic and diluted	**28,150,319**	**28,270,902**	**28,407,093**	**28,489,043**

2002	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	$ –	$ –	$ –	$ –
Operating expenses	7,336,945	6,906,686	5,478,910	5,872,425
Net loss	(7,020,273)	(6,624,749)	(5,233,928)	(5,675,960)
Net loss per share of common stock				
Basic and diluted	$ (0.25)	$ (0.24)	$ (0.19)	$ (0.20)
Number of shares used in per share calculation				
Basic and diluted	28,038,315	28,077,945	28,100,495	28,131,485

Because of the method used in calculating per share data, the quarterly per share data will not necessarily add to the per share data as computed for the year.

Corporate Information

COMPANY OFFICERS

John R. Plachetka, Pharm.D.
Chairman, President and Chief Executive Officer

Kristina M. Adomonis
Senior Vice President, Business Development

W. James Alexander, M.D., M.P.H.
Senior Vice President, Product Development

John E. Barnhardt
Vice President, Finance and Administration

BOARD OF DIRECTORS

John R. Plachetka, Pharm.D.
Chairman, President and Chief Executive Officer

Peter J. Wise, M.D.
Vice Chairman, POZEN Inc.

James R. Butler
Former President, ALZA International

Arthur S. Kirsch
Managing Director, Vector Securities International, LLC

Kenneth B. Lee Jr.
General Partner, Hatteras BioCapital, LLC

Paul J. Rizzo
Chairman of the Board and Partner, Franklin Street Partners

Bruce A. Tomason
Chief Executive Officer, Aterna, LLC

Ted G. Wood
Former Vice Chairman, The United Company

CORPORATE HEADQUARTERS

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STOCK TRANSFER AGENT AND REGISTRAR

StockTrans, Inc.
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Ardmore, PA 19003

INDEPENDENT ACCOUNTANTS

Ernst & Young LLP
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3200 Beechleaf Court
Raleigh, NC 27604

COMMON STOCK LISTING

Ticker Symbol: POZN
Nasdaq Stock Market

ANNUAL MEETING

Tuesday, June 22, 2004

STOCKHOLDERS' INQUIRIES

Stockholders and prospective investors seeking information about POZEN should visit the Company's website at www.pozen.com or contact POZEN's Investor Relations Department at (919) 913-1030.

FORWARD LOOKING STATEMENTS

Statements included in this annual report that are not historical in nature are "forward-looking statements" within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. You should be aware that our actual results could differ materially from those contained in the forward-looking statements, which are based on management's current expectations and are subject to a number of risks and uncertainties, including, but not limited to, our failure to successfully commercialize our product candidates; costs and delays in the development and/or FDA approval, or the failure to obtain such approval of our product candidates; uncertainties in clinical trial results or the timing of such trials, resulting in, among other things, an extension in the period over which we recognize deferred revenue or our failure to achieve milestones that would have provided us with revenue; our inability to maintain or enter into, and the risks resulting from our dependence upon, collaboration or contractual arrangements necessary for the development, manufacture, commercialization, marketing, sales and distribution of any products; competitive factors; our inability to protect our patents or proprietary rights and obtain necessary rights to third party patents and intellectual property to operate our business; our inability to operate our business without infringing the patents and proprietary rights of others; general economic conditions; the failure of any products to gain market acceptance; our inability to obtain any additional required financing; technological changes; government regulation; changes in industry practice; and one-time events, including those discussed herein and in our Annual Report and on our Form 10-Q for the quarter ended March 31, 2004 under "Management's Discussion and Analysis of Financial Condition and Results of Operations." We do not intend to update any of these factors or to publicly announce the results of any revisions to these forward-looking statements.

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