

Consolidated Financial Statements

Pacgen Biopharmaceuticals Corporation

(a development stage enterprise)

(Expressed in Canadian dollars)

March 31, 2008 and 2007

Pacgen Biopharmaceuticals Corporation

(a development stage enterprise)

Incorporated under the Business Corporation Act (British Columbia)

CONSOLIDATED BALANCE SHEETS

[See Note 1 – Nature of Operations and Going Concern]

(expressed in Canadian dollars)

	March 31, 2008	March 31, 2007
	\$	\$
ASSETS		
Current		
Cash and cash equivalents <i>[note 6]</i>	1,438,691	5,387,366
Amounts receivable	12,800	132,060
Prepaid expenses and other	469,307	941,629
Total current assets	1,920,798	6,461,055
Property and equipment <i>[note 7]</i>	101,236	134,433
Intangible assets <i>[notes 5 and 8]</i>	1,002,203	1,239,178
Total assets	3,024,237	7,834,666
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	1,378,733	1,240,599
Current portion of deferred leasehold inducement	6,916	—
	1,385,649	1,240,599
Deferred leasehold inducement	10,375	-
Future income tax liability <i>[note 12]</i>	—	85,000
Total liabilities	1,396,024	1,325,599
Commitments and contingencies <i>[notes 8, 10 and 11]</i>		
Shareholders' equity		
Share capital <i>[note 9]</i>		
Issued and outstanding:		
Common shares <i>[note 9(a)]</i>	13,012,118	12,286,556
Preferred shares <i>[note 9(b)]</i>	—	—
Contributed surplus <i>[notes 8(b) and 9(e)]</i>	1,163,776	795,480
Deficit	(12,547,681)	(6,572,969)
Total shareholders' equity	1,628,213	6,509,067
Total liabilities and shareholders' equity	3,024,237	7,834,666

See accompanying notes

On behalf of the Board:

/s/ Michael A. Evans
Director

/s/ Kevin McGarry
Director

Pacgen Biopharmaceuticals Corporation
(a development stage enterprise)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS**

(expressed in Canadian dollars)

	Year ended March 31, 2008 \$	Year ended March 31, 2007 \$	Cumulative from Inception to March 31, 2008 \$
EXPENSES			
Research and development	3,480,523	1,987,583	6,330,430
General and administration	1,901,567	1,790,765	5,026,968
Stock based compensation [note 9(e)]	346,348	580,825	927,173
Amortization	269,245	242,274	533,503
	5,997,683	4,601,447	12,818,074
OTHER			
Interest and other income	94,838	100,482	224,806
Loss on disposal of property and equipment	(9,089)	—	(9,089)
Foreign exchange losses	(147,778)	(5,872)	(183,324)
	(62,029)	94,610	32,393
Loss before income taxes	(6,059,712)	(4,506,837)	(12,785,681)
Future income tax recovery [note 12]	85,000	153,000	238,000
Net loss and comprehensive loss for the period	(5,974,712)	(4,353,837)	(12,547,681)
Basic and diluted loss per common share	(0.19)	(0.20)	
Weighted average number of common shares outstanding	30,711,416	21,941,822	

See accompanying notes

Pacgen Biopharmaceuticals Corporation
(a development stage enterprise)

CONSOLIDATED STATEMENTS OF CASH FLOWS

(expressed in Canadian dollars)

	Year ended March 31, 2008 \$	Year ended March 31, 2007 \$	Cumulative from Inception to March 31, 2008 \$
OPERATING ACTIVITIES			
Loss for the period	(5,974,712)	(4,353,837)	(12,547,681)
Add items not affecting cash:			
Amortization	269,245	242,274	533,503
Deferred leasehold inducement	(1,153)	—	(1,153)
Future income tax recovery	(85,000)	(153,000)	(238,000)
Loss on disposal of property and equipment	9,089	—	9,089
Stock based compensation	346,348	580,825	927,173
Unrealized foreign exchange loss	87,936	—	87,936
Write-off of research supplies	—	—	17,819
Write-off of withholding tax receivable	5,548	—	5,548
	(5,342,699)	(3,683,738)	(11,205,766)
Changes in non-cash working capital items relating to operations:			
Amounts receivable	119,260	40,333	130,694
Prepaid expenses and other	384,386	(891,643)	(575,062)
Accounts payable and accrued liabilities	138,134	1,112,556	1,352,741
Cash used in operating activities	(4,700,919)	(3,422,492)	(10,297,393)
INVESTING ACTIVITIES			
Acquisition of IL Therapeutics Inc.	—	1,257,992	1,257,992
Deferred acquisition costs	—	—	(20,903)
Proceeds from disposal of property and equipment	5,775	—	5,775
Purchase of property and equipment	(19,485)	(114,980)	(179,202)
Purchase of intangible assets	—	—	(59,743)
Leasehold inducement	18,444	—	18,444
Cash provided by investing activities	4,734	1,143,012	1,022,363
FINANCING ACTIVITIES			
Issuance of common shares for cash, net of share issuance costs	747,510	6,939,782	8,887,292
Issuance of preferred shares for cash, net of share issuance costs	—	—	1,131,594
Advance from related party	—	—	694,836
Cash provided by financing activities	747,510	6,939,782	10,713,721
Increase (decrease) in cash and cash equivalents	(3,948,675)	4,660,302	1,438,691
Cash and cash equivalents, beginning of period	5,387,366	727,064	—
Cash and cash equivalents, end of period	1,438,691	5,387,366	1,438,691
Other supplemental cash flow information			
Preferred shares issued for technology [note 5]	—	918,876	918,876
Common shares issued for technology [notes 5 and 8(b)]	—	1,081,124	1,561,124
Preferred shares issued to agent as compensation [note 9(b)]	—	—	52,544
Common shares issued to agent as compensation [notes 5 and 9(a)(ii)]	21,546	130,000	151,546
Common shares issued to settle related party advance	—	—	718,836

See accompanying notes

Pacgen Biopharmaceuticals Corporation
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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(expressed in Canadian dollars)

	Common Shares		Preferred Shares		Contributed	Deficit	Total
	Number	Amount	Number	Amount	Surplus	\$	\$
		\$		\$	\$		
Balance, March 31, 2006	16,182,554	2,374,836	2,661,333	1,131,593	30,000	(2,219,132)	1,317,297
Issued pursuant to acquisition of IL Therapeutics Inc.	1,500,000	1,106,124	1,250,000	918,876	—	—	2,025,000
Issued for cash upon exercise share purchase warrants	2,039,287	1,019,645	—	—	—	—	1,019,645
Issued for cash pursuant to a public offering	6,788,786	5,920,137	—	—	—	—	5,920,137
Compensation to public offering agent	100,000	(184,655)	—	—	184,655	—	—
Conversion of preferred shares to common shares	3,911,333	2,050,469	(3,911,333)	(2,050,469)	—	—	—
Stock based compensation	—	—	—	—	580,825	—	580,825
Net loss for the period	—	—	—	—	—	(4,353,837)	(4,353,837)
Balance, March 31, 2007	30,521,960	12,286,556	—	—	795,480	(6,572,969)	6,509,067
Issued for cash pursuant to a private placement	4,515,003	747,510	—	—	—	—	747,510
Value of share purchase warrant pursuant to a private placement	—	(2,535)	—	—	2,535	—	—
Compensation to private placement agent	107,730	(19,413)	—	—	19,413	—	—
Stock based compensation	—	—	—	—	346,348	—	346,348
Net loss for the period	—	—	—	—	—	(5,974,712)	(5,974,712)
Balance, March 31, 2008	35,144,693	13,012,118	—	—	1,163,776	(12,547,681)	1,628,213

See accompanying notes

Pacgen Biopharmaceuticals Corporation
(a development stage enterprise)

**NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS**

March 31, 2008 and 2007

(expressed in Canadian dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

Pacgen Biopharmaceuticals Corporation (the "Company") was incorporated under the Business Corporations Act (British Columbia) on April 23, 2004. The Company is a life science company focused on developing therapeutic drugs for the treatment of infectious and inflammatory diseases. The Company is considered to be in the development stage, as most of its efforts have been devoted to research and development of its proposed drug products, raising capital and recruitment of personnel.

These consolidated financial statements have been prepared on the basis of accounting principles on a going concern which assumes the realization of assets and satisfaction of liabilities in the normal course of business. The use of these principles may not be appropriate because as of March 31, 2008, there was substantial doubt that the Company will be able to continue as a going concern without raising additional financial resources.

The Company has incurred losses from operations since inception and has accumulated a deficit of \$12,547,681 as at March 31, 2008. The Company has funded its operations primarily by share issuances. The Company's ability to continue as a going concern is dependent upon its ability to obtain additional financing. The Company is currently seeking additional capital to finance its operations. Management is considering all financing alternatives, including equity financing, corporate collaboration and licensing arrangement. There can be no assurance that such financing will materialize on a timely basis or obtained on favorable terms. If the Company is unable to obtain additional financing, management may be required to curtail the Company's operations.

These consolidated financial statements do not give effect to any adjustment to the amounts or classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are presented in Canadian dollars. The following is a summary of significant accounting policies used in the preparation of these consolidated financial statements.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Pacgen Biopharmaceuticals Corporation (Taiwan Branch) and IL Therapeutics Inc. which were incorporated in Taiwan and in Canada under the Canada Business Corporations Act, respectively. All significant inter-company balances and transactions have been eliminated on consolidation.

Pacgen Biopharmaceuticals Corporation
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**NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS**

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(expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Use of estimates

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the consolidated financial statements. Significant areas requiring the use of estimates relate to the assessment for impairment and useful lives of intangible assets, determination of share value in transactions where shares are issued as a consideration, accrued liabilities, estimation of income tax expense and determination of fair value of stock-based compensation. The reported amounts and note disclosures are determined using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned course of actions. Actual results may differ from those estimates.

Foreign currency translation

The Company follows the temporal method of accounting for the translation of foreign currency amounts into Canadian dollars. Under this method, monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using the exchange rate in effect on the balance sheet date. All other assets and liabilities are translated at the exchange rates in effect on the transaction dates. Revenue and expense items are translated at the average exchange rates prevailing during the period except for amortization which is translated using historical rates. Foreign exchange gains and losses, both realized and unrealized, are included in the determination of the loss for the period.

Cash and cash equivalents

The Company considers all highly liquid financial instruments with a maturity of 90 days or less when purchased to be cash equivalents. Cash equivalents are carried at cost, which approximate their market values. Interest earned is recognized in operations. At March 31, 2008 and 2007, cash and cash equivalents consisted of cash on deposit with banks.

Property and equipment

Property and equipment are recorded at cost less accumulated amortization. Amortization is provided based on the estimated useful lives of the property and equipment using the following methods and annual rates:

Computer equipment	30% declining balance
Computer software	2 years straight-line
Leasehold improvement	Term of lease
Motor vehicles	5 years straight-line
Office furniture and equipment	20% declining balance

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2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Intangible assets

Intangible assets of the Company include technology licenses and rights acquired from third parties. Technology licenses and rights are initially recorded at the fair value based on consideration paid and are amortized on a straight-line basis over the estimated useful life of the underlying technologies of 5 to 10 years. The Company reviews the estimated useful lives and carrying values of its technology licenses and rights as part of its periodic assessment for impairment of long-lived assets. No impairment adjustment has been recorded to date.

The amount shown for technology licenses and rights do not necessarily reflect present or future value and the ultimate amount recoverable will be dependent upon the successful development and commercialization of products based on these underlying technologies.

Impairment of long-lived assets

Property and equipment, and intangible assets with finite life are reviewed for potential impairment whenever events or changes in circumstances indicating that the carrying value of these assets may not be recoverable. If the estimated net recoverable value, calculated based on the estimated undiscounted future cash flow, is less than the carrying value of the underlying technology, then the carrying value is written down to its fair value, based on the related estimated discounted future cash flow. No impairment adjustment has been recorded to date.

Deferred leasehold inducement

Deferred leasehold inducement, which is comprised of a tenant improvement allowance, is being amortized to reduce rent expense on a straight-line basis over the initial term of lease as a reduction on rent expense.

Research and development costs

Research costs, including costs for new patents and patent applications, are expensed in the period in which they are incurred. Development costs are expensed in the period in which they are incurred unless such development costs meet the criteria under Canadian generally accepted accounting principles for deferral and amortization. No development cost has been deferred to date.

Contract research and development expenses, including fees paid to contract research organizations, investigators and other vendors who conduct certain product development activities on behalf of the Company, are recognized in a period based on estimates of the work performed using an accrual basis of accounting. These estimates are based on patient enrolment, services provided and goods delivered, contractual terms and experience with similar contracts. The Company monitors these factors to the extent possible and adjust the estimates accordingly.

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**NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS**

March 31, 2008 and 2007

(expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Research and development costs (cont'd.)

Amounts advanced to third parties in connection with planned future research and development activities are deferred as prepaid expenses and are expensed as research and development costs based on work performed during the period.

Future income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between carrying values of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, measured using substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future income tax assets, net of a valuation allowance, are recorded in the financial statements if realization is considered more likely than not.

Stock-based compensation

The Company grants stock options to employees, directors, and consultants pursuant to a stock option plan described in note 9(e). The Company uses the fair value method to account for all stock-based awards granted, modified or settled, and the Black-Scholes option pricing model to determine the fair value of stock options granted. As such, a compensation expense is recorded based on the estimated fair value of options with a corresponding credit to contributed surplus. Any consideration received on the exercise of stock options is credited to share capital.

The fair value of stock-based awards to employees and directors is measured on the date of grant and amortized over the vesting period. The fair value of stock-based awards to consultants is measured at the performance commitment date or the date that the service is delivered.

Loss per common share

Basic loss per common share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per common share is equivalent to the basic loss per common share as the effect of outstanding warrants and options disclosed in note 9 are anti-dilutive for all periods presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008 and 2007

(expressed in Canadian dollars)

3. CHANGES IN ACCOUNTING POLICIES

Comprehensive income and equity

Effective April 1, 2007, the Company adopted the new recommendations of the CICA Handbook Section 1530, “*Comprehensive Income*” and Section 3251, “*Equity*”. The adoption of these Handbook Sections had no impact on opening deficit.

- Section 1530 provides standards for reporting and display of comprehensive income, which is defined as the change in equity from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP.
- Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530.

The adoption of these new Handbook sections had no impact on the consolidated financial statements for the year ended March 31, 2008.

Financial instruments

Effective April 1, 2007, the Company also adopted the new recommendations of the CICA Handbook Section 3855, “*Financial Instruments – Recognition and Measurement*” and Section 3861, “*Financial Instruments – Disclosure and Presentation*”. These new accounting standards, which apply to fiscal years beginning on or after October 1, 2006, provide comprehensive requirements for the recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Under the new standards, policies followed for periods prior to the effective date generally are not reversed and therefore, the comparative figures have not been restated. The adoption of these Handbook Sections had no impact on opening deficit.

- Section 3855 requires financial instruments be classified into one of five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. All financial instruments, including derivatives, are initially measured on the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income. Transaction costs are included in the initial carrying amount of financial instruments except for held-for-trading items in which case they are expensed as incurred. Section 3855 also requires that the embedded derivatives to be identified and separated from the related host contract and be measured at fair value. Subsequent changes in fair value of embedded derivatives are recognized in the consolidated statement of operations in the period the change occurs.

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**NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS**

March 31, 2008 and 2007

(expressed in Canadian dollars)

3. CHANGES IN ACCOUNTING POLICIES (cont'd.)

Financial instruments (cont'd.)

- Section 3861 establishes the requirements for presentation and disclosure of financial instruments and non-financial derivatives.

Upon adoption of these new standards, the Company has classified cash and cash equivalents as held-for-trading, amounts receivables as loans and receivables and all financial liabilities as other financial liabilities. The adoption of these new Handbook sections had no impact on the consolidated financial statements for the year ended March 31, 2008.

Accounting changes

In July 2006, the CICA revised Section 1506, "Accounting Changes", which now requires that: (i) a voluntary change in accounting principles can be made if, and only if, it is required by primary source of Canadian GAAP or the changes result in more reliable and relevant information, (ii) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and (iii) for changes in estimates, the nature and amount of the change should be disclosed. The revised section is effective for the Company's financial year beginning April 1, 2007 for fiscal year 2008. The adoption of this section does not have an impact on the Company's consolidated financial statements for the year ended March 31, 2008.

New accounting pronouncements

The Canadian Accounting Standards Board (AcSB) issued two new Sections in relation to financial instruments: Section 3862, "Financial Instruments – Disclosure", and Section 3863, "Financial Instruments – Presentation". Both sections will become effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company will adopt these standards commencing April 1, 2008. The adoption of these new standards is not expected to have material impact on the Company's consolidated financial statements.

The AcSB issued Section 1535, "Capital Disclosures". This standard requires disclosure regarding what the Company defines as capital and its objectives, policy and processes for managing capital. This standard will be effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company will adopt these standards commencing April 1, 2008. The adoption of these new standards is not expected to have material impact on the Company's consolidated financial statements.

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(expressed in Canadian dollars)

3. CHANGES IN ACCOUNTING POLICIES (cont'd.)

New accounting pronouncements (cont'd.)

In January 2006, CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) for accounting periods commencing on or after January 1, 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets”, which replaces Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs”. Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The new Section will be applicable to the Company’s consolidated financial statements for its fiscal year beginning April 1, 2009. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

4. FINANCIAL INSTRUMENTS AND RISK

The carrying values of the Company’s cash and cash equivalents, amounts receivable, and accounts payable approximate their fair values due to their short term to maturity.

Financial risk to the Company’s results of operations arises from the fluctuations and the degree of volatility of foreign currency exchange rates, as the Company’s cash and cash equivalents which finance operations are substantially denominated in Canadian dollars and a significant portion of the Company’s expenses are denominated in United States dollars. The Company also incurred expenses in New Taiwanese dollars.

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**NOTES TO CONSOLIDATED
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5. ACQUISITION OF IL THERAPEUTICS INC.

On April 4, 2006, the Company completed the acquisition (the "ILT Acquisition") of all of the issued and outstanding shares of IL Therapeutics Inc. ("ILT") comprised of common shares and retractable investment shares. The ILT Acquisition provided the Company approximately \$1.5 million in working capital and certain technology relating to the prevention and treatment of severe inflammatory diseases characterized with neutrophil over-recruitment. This technology relates to its PAC-G31P drug candidate. The consideration for the ILT Acquisition comprised 1,250,000 preferred shares, 1,470,588 common shares and 1,250,000 common share purchase warrants of the Company, at an aggregate fair value of \$2,000,000. Each common share purchase warrant entitles the holder to purchase one common share at any time until December 7, 2008, the second anniversary of the initial public offering of the Company (the "IPO"), at \$1.16 per share.

In connection with the ILT Acquisition, the Company paid a financial consulting firm, of which a director is an executive, a cash finder's fee of \$75,000 and 29,412 common shares at a fair value of \$25,000. In addition, the Company incurred additional professional service fees of \$46,639 directly related to the acquisition.

As ILT was a development stage company that did not meet the definition of a business under Canadian GAAP, the transaction was accounted for as an asset acquisition, and not as a business combination. The purchase price has been allocated to ILT's identifiable assets and liabilities as follows:

	Amount
	\$
<hr/>	
Identifiable assets acquired:	
Cash	1,358,728
Other current assets	143,494
Property and equipment	1,000
Technology	907,409
Liabilities assumed:	
Accounts payable and accrued liabilities	(25,992)
Net future income tax liability	(238,000)
	<hr/>
	2,146,639
<hr/>	
Consideration:	
Equity securities	2,025,000
Acquisition expenses	121,639
	<hr/>
	2,146,639
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ILT was a development stage company with nominal assets, other than cash and operations at the date of acquisition. Accordingly, the majority of the purchase price has been allocated to the acquired intangible assets which are being amortized over 5 years.

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6. CASH AND CASH EQUIVALENTS

As at March 31, 2008, cash and cash equivalents include \$900,000 [2007 - \$5,110,578] of Canadian dollars term deposits with a weighted average interest rate of 3.84% [2007 - 3.89%].

7. PROPERTY AND EQUIPMENT

	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
March 31, 2008			
Computer equipment and software	55,280	25,450	29,830
Leasehold improvement	41,346	8,083	33,263
Motor vehicles	—	—	—
Office furniture and equipment	50,456	12,313	38,143
	147,082	45,846	101,236
March 31, 2007			
Computer equipment and software	47,590	7,798	39,792
Leasehold improvement	41,346	2,036	39,310
Motor vehicles	17,916	7,216	10,700
Office furniture and equipment	53,866	9,235	44,631
	160,718	26,285	134,433

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(expressed in Canadian dollars)

8. INTANGIBLE ASSETS

	March 31, 2008	March 31, 2007
	\$	\$
Technology, licenses and rights		
Cost	1,477,151	1,477,151
Accumulated amortization	474,948	237,973
	1,002,203	1,239,178

- [a] On February 1, 2005, the Company entered into a license agreement with Demegen, Inc. (“Demegen”), a third party, to acquire an exclusive world-wide license, with a right to sublicense, use, improve, develop and commercially exploit certain patented technologies for the treatment of human oral disease conditions (the “Demegen Sublicense”). These technologies were licensed to Demegen by Boston University. The Demegen Sublicense contains an agreement with Boston University to secure a direct license to the Company should Demegen fail to meet its obligations to Boston University. In consideration for the Demegen Sublicense, the Company paid Demegen an initial license fee of US\$50,000 payable in two installments of US\$25,000 in March 2005 and in September 2005. In addition to the initial license fee and subsequent license fee, the Company is required to pay royalties based on product sales or sublicense revenue, with a minimum annual royalty payment of US\$50,000 per annum. The first minimum royalty payment was due on or before March 31, 2006 and continues each year thereafter. The Company paid all its minimum royalty payments as of March 31, 2008. The Company is also required to pay an annual maintenance fee of US\$50,000 for each year if any agreed clinical development milestone is not met. The Company met the agreed milestone required as of March 31, 2008. This agreement remains in effect until the abandonment, lapse or expiration of the last licensed patent, unless earlier terminated by either party in accordance with the terms of the agreement.
- [b] On January 2, 2006, the Company entered into an amendment agreement with Demegen to revise the royalty payment terms of the Demegen Sublicense. In exchange for a reduced percentage of royalties on net product sales and net sublicenses revenue, the Company issued to Demegen 800,000 common shares of the Company at a deemed price of \$0.60 per share, based on recent common and preferred share issuances for cash consideration, and 500,000 share purchase options with a fair value of \$30,000 with an exercise price of \$2.25 per share until December 7, 2008, second anniversary of the Company’s IPO completion date. The fair value of the common shares issued of \$480,000 and the fair value of the share purchase options granted of \$30,000 has been credited to share capital and contributed surplus, respectively with corresponding increases in technology license and rights [notes 9(a) and (d)].

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**NOTES TO CONSOLIDATED
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(expressed in Canadian dollars)

9. SHARE CAPITAL

[a] Common shares

	Number of Shares	Amount \$
Authorized		
Unlimited number of common shares without par value		
Balance, March 31, 2006	16,182,554	2,374,836
Issued pursuant to ILT Acquisition <i>[note 5]</i>	1,500,000	1,106,124
Issued for cash upon exercise of share purchase warrants	2,039,287	1,019,645
Issued for cash pursuant to a public offering <i>[i]</i>	6,888,786	5,735,512
Conversion of preferred shares to common shares <i>[note 9(b)]</i>	3,911,333	2,050,469
Balance, March 31, 2007	30,521,960	12,286,556
Issued for cash pursuant to a private placement <i>[ii]</i>	4,622,733	725,562
Balance, March 31, 2008	35,144,693	13,012,118

[i] On December 7, 2006, the Company closed its IPO of 6,788,786 units at \$1.05 per unit for total gross proceeds of \$7,128,225. Each unit comprised of one common share of the Company and one half of one common share purchase warrant. One whole warrant entitled the holder to purchase one common share of the Company at \$1.30 per share until December 7, 2007. In connection with the IPO, the Company paid a cash commission of \$419,957 and issued 543,102 agent warrants (the "Agents' Warrants") to the underwriting agents with a fair value of \$184,655 using Black Schole Pricing Model with following assumptions:

Volatility	80.30%
Expected life of options	2 years
Dividend yield	0.00%
Risk free interest rate	4.00%

Each Agents' Warrant is exercisable for one common share of the Company at \$1.05 per share until December 7, 2008. In addition, the Company also paid the lead underwriting agent an administration fee of \$5,000 and issued 100,000 common shares as corporate finance fees. The Company also incurred professional and other financing cost of \$783,131.

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9. SHARE CAPITAL (cont'd.)

[a] Common shares (cont'd.)

[ii] On March 17, 2008, the Company closed a private placement of 4,515,003 units (the "Units") at \$0.20 per unit for total gross proceeds of \$903,000. Each Unit was comprised of one common share of the Company and one common share purchase warrant. One common share purchase warrant entitled the holder to purchase one common share of the Company at \$0.30 per share until March 16, 2013. In connection with the private placement, the Company issued 107,730 units as compensation (the "Compensation Units") and 34,200 broker warrants (the "Broker's Warrants") to an agent. Each Compensation Unit was converted to one common share and one common share purchase warrant at no cost to the agent. Each Broker's Warrant is exercisable into one Unit at \$0.22 per Unit until March 16, 2010. Upon exercise, each Broker Warrant will convert to one common share, and one common share purchase warrant exercisable into one additional common share at \$0.30 per share until March 16, 2013. The Compensation Units and Broker's Warrants have an estimated value of \$40,960.

The Company adopted the Residual Approach in valuing the share purchase warrants attached to the private placement units issued. Under this approach, proceeds up to the Company's share market value are allocated to the shares and only the excess above the market value is allocated to the attached share purchase warrants. A value of \$2,535 has been allocated to these warrants as determined under the Residual Approach.

The Company also incurred professional and other financing cost of \$155,490.

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9. SHARE CAPITAL (cont'd.)

[b] Preferred shares

	Number of Shares	Amount \$
Authorized		
Unlimited number of preferred shares without par value		
Issued and outstanding		
Balance, March 31, 2006	2,661,333	1,131,593
Issued pursuant to the ILT Acquisition <i>[note 5]</i>	1,250,000	918,876
Conversion of preferred shares to common shares	(3,911,333)	(2,050,469)
Balance, March 31, 2007 and 2008	—	—

On November 28, 2005, the Company completed a private placement of 2,261,333 units at a price of \$0.60 per unit for total gross proceeds of \$1,356,800. Each unit is comprised of one preferred share and one common share purchase warrant of the Company. Each preferred share will automatically convert into one common share on the closing day of the IPO. Each common share purchase warrant entitles the holder to purchase one common share of the Company at a price equivalent to a 10% premium to the IPO closing price. The common share purchase warrant expires prior to the second anniversary of the IPO. In connection with the unit offering the Company paid a cash commission of \$52,544, issued 400,000 units at a deemed value of \$0.60 per unit, and issued 87,573 common share purchase warrants to the agents. Each of these agent warrants entitles the holder to purchase one common share of the Company at \$1.16 until December 7, 2008. The Company also incurred legal and professional fees of \$172,663.

The preferred shares rank in priority to the common shares on the liquidation, dissolution or winding-up of the Company. In accordance to the share purchase agreement, the preferred shares automatically converted into common shares on a one to one basis on November 28, 2006, when the Company obtained a receipt for its final prospectus with respect to its IPO.

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9. SHARE CAPITAL (cont'd.)

[c] Common share purchase warrants

	Number	Weighted Average Exercise Price \$
Balance, March 31, 2006	5,148,906	0.85
Issued on April 4, 2006 the ILT Acquisition [note 5]	1,250,000	1.16
Exercised during the period	(2,039,287)	0.50
Expired on December 7, 2006	(360,713)	0.50
Issued on December 7, 2006 the IPO [note 9(a)(i)]	3,394,393	1.30
Issued on December 7, 2006 the IPO [note 9(a)(i)]	543,102	1.05
Balance, March 31, 2007	7,936,401	1.21
Expired on December 7, 2007	(3,394,393)	1.30
Issued on March 17, 2008 [note 9(a)(ii)]	4,515,003	0.30
Issued on March 17, 2008 [note 9(a)(ii)]	107,730	0.30
Issued on March 17, 2008 [note 9(a)(ii)] ⁽¹⁾	34,200	0.22
Balance, March 31, 2008	9,198,941	0.72

Date of Expiry	Exercise Price	Number of Warrants
December 7, 2008 [note 9(b)]	\$1.16	2,748,906
December 7, 2008 [note 5]	\$1.16	1,250,000
December 7, 2008 [note 9(a)(i)]	\$1.05	543,102
March 16, 2013 [note 9(a)(ii)]	\$0.30	4,622,733
March 16, 2010 [note 9(a)(ii)] ⁽¹⁾	\$0.22	34,200
Balance, March 31, 2008	\$0.72	9,198,941

⁽¹⁾ Upon exercise, each Broker Warrant will convert to one common share, and one common share purchase warrant exercisable into one additional common share at \$0.30 per share until March 16, 2013. After giving effect to the conversion of these Broker Warrants, there are 9,233,141 common share purchase warrants outstanding, at an average exercise price of \$0.72, as of March 31, 2008.

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9. SHARE CAPITAL (cont'd.)

[d] Share purchase options

	Number	Weighted Average Exercise Price \$
Balance March 31, 2006	500,000	\$2.25
Granted	—	—
Forfeited	—	—
Balance, March 31, 2007 and 2008	500,000	2.25

As at March 31, 2008, the 500,000 options outstanding are fully exercisable until December 7, 2008 [note 8(b)].

The fair value of the 500,000 options issued during the year ended March 31, 2007 was determined to be \$30,000 estimated using the Black-Scholes valuation model using the following assumptions:

Volatility	75.00%
Expected life of options	2 years
Dividend yield	0.00%
Risk free interest rate	4.00%

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9. SHARE CAPITAL (cont'd.)

[e] Stock options

On August 22, 2006, the Company adopted a stock option plan (the "Stock Option Plan") providing the granting of options to employees, officers, directors, consultants and scientific advisory board members. The maximum number of common shares that are issuable under the Stock Option Plan is an aggregate of 10% of the issued and outstanding common share, calculated as at the award date of the options. The maximum number of common shares that may be optioned in favour of any single individual will not exceed 5% of the issued and outstanding common shares at the date of grant. The maximum number of common shares that may be optioned in favour of directors and senior officers under the Stock Option Plan is 10% of the issued and outstanding common shares at the date of grant.

Details of stock option transactions during the years ended March 31, 2008 and 2007 are summarized as follows:

	Number	Weighted Average Exercise Price \$
Balance, March 31, 2006	—	—
Granted	3,207,000	1.04
Forfeited	(708,000)	1.13
Balance, March 31, 2007	2,499,000	1.02
Granted	229,000	0.70
Forfeited	(94,000)	1.02
Balance, March 31, 2008	2,634,000	0.99

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9. SHARE CAPITAL (cont'd.)

[e] Stock options (cont'd.)

At March 31, 2008, stock options to executive officers and directors, employees, consultants and clinical advisory board members were outstanding as follows:

Options Outstanding				Options Exercisable	
Range of Exercise Price	Number of Common Shares Issuable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Number of Common Shares Issuable	Weighted Average Exercise Price (\$)
\$0.50 - \$0.85	685,000	7.02	0.64	288,333	0.64
\$1.00 - \$1.05	859,000	4.58	1.05	703,917	1.05
\$1.10 - \$1.16	1,090,000	6.46	1.16	650,000	1.16
	2,634,000	6.00	0.99	1,642,250	1.02

As of March 31, 2008, stock options to employees, officers, directors, consultants and scientific advisory board members were outstanding as follows:

	Exercise Price	Number of Options Outstanding	Number of Options Exercisable
Date of Expiry			
August 22, 2014	\$0.50	10,000	10,000
August 22, 2008	\$1.00	40,000	40,000
August 22, 2009	\$1.05	80,000	80,000
August 22, 2011	\$1.05	150,000	150,000
August 22, 2014	\$1.05	242,000	165,334
August 22, 2014	\$1.16	940,000	560,000
March 6, 2012	\$1.05	180,000	180,000
March 6, 2015	\$1.05	127,000	58,583
March 6, 2015	\$1.16	150,000	90,000
March 27, 2015	\$0.65	500,000	233,333
May 31, 2012	\$1.05	40,000	30,000
May 31, 2015	\$0.62	18,000	18,000
May 31, 2015	\$0.63	157,000	27,000
Balance, March 31, 2008		2,634,000	1,642,250

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9. SHARE CAPITAL (cont'd.)

[e] Stock options (cont'd.)

The fair value of the stock options granted during the year ended March 31, 2008 was estimated using the Black-Scholes valuation model with the following assumptions:

Volatility	88.90 – 105.16%
Expected life of options	2 – 5 years
Dividend yield	0.00%
Risk free interest rate	4.00 – 4.01%

The estimated fair value of options granted to employees including officers and directors, and non-employees are as follows:

	March 31 2008	March 31 2007
	\$	\$
Employees	331,853	535,563
Non-employees	14,495	45,262
	346,348	580,825

Option-pricing models require the use of highly subjective estimates and assumptions including the expected stock price volatility. Changes in the underlying assumptions can materially affect the fair value estimates.

10. COMMITMENTS

[a] Operating leases

The Company has entered into lease agreements for its office premises in Canada for terms of up to five years expiring March 28, 2012. Future minimum annual lease payments under the leases are as follows:

	\$
2009	98,273
2010	99,218
2011	51,377
2012	3,537
2013	—
	252,405

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10. COMMITMENTS (cont'd.)

[b] Clinical research and development agreements

The Company has entered into various clinical research and development agreements with third parties which require the Company to fund research and development expenditures of \$2,969,932 for the fiscal year ending March 31, 2009. Of these commitments, \$454,528 are non-cancellable and \$2,515,404 are cancellable for fiscal year ending March 31, 2009.

[c] License agreements

- [i] Pursuant to the Demegen Sublicense, the Company is required to make minimum annual royalty payments of US\$50,000 for the period until the expiry date of the last patent right and to pay an annual maintenance fee of US\$50,000 if any of the agreed clinical development milestones are not met *[note 8(a)]*.
- [ii] Pursuant to a license agreement between the Company's wholly owned subsidiary, ILT, and University of Saskatchewan (the "US License"), the Company is responsible for up to \$510,000 of milestone payments linked to successful completion of preclinical proof of concept (\$60,000 paid), successful filing of investigational new drug application (\$25,000) and successful completion of Phase I to Phase III clinical studies (amount to \$425,000) of the licensed technology. The Company is also responsible for up to \$1,070,000 of milestone payments linked to marketing approval in five regions (United States, Europe, Japan, Canada and Hong Kong) and another one time payment of \$100,000 for an added indication in any country. The Company is further obligated to pay royalties on sales revenue and sub-licensing revenue.

Also as part of the US License, the Company has agreed to provide funding to the University of Saskatchewan. The research will cover but is not limited to research related to the licensed technology for not less than \$500,000 within the first five years of the term of the license agreement, with minimum \$100,000 per year for the first two years (\$273,000 has been paid to date).

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11. CONTINGENCIES

The Company has entered into license and research agreements with third parties that include indemnification provisions that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party claims or damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is unlimited. These indemnification provisions may survive termination of the underlying agreement. The nature of the indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

12. INCOME TAXES

At March 31, 2008, the Company has non-capital loss carryforwards and investment tax credits available to offset future taxable income and future income taxes payable in Canada, respectively that expire as follows:

	Federal Investment Tax Credits	Provincial Investment Tax Credits	Non-Capital Losses
	\$	\$	\$
2011	—	—	11,000
2015	—	—	287,000
2016	—	24,000	687,000
2017	—	74,000	—
2018	—	53,000	—
2026	43,000	—	—
2027	171,000	—	3,548,000
2028	107,000	—	5,194,000
	<u>321,000</u>	<u>151,000</u>	<u>9,727,000</u>

In addition, the Company has unclaimed tax deductions of approximately \$1,489,000 related primarily to scientific research and experimental development expenditures available to carryforward indefinitely to reduce taxable income of future years.

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12. INCOME TAXES (cont'd.)

Significant components of the Company's future tax assets and liabilities as of March 31, 2008 are shown below:

	2008	2007
	\$	\$
Future tax assets:		
Tax basis in excess of accounting value	(108,000)	192,000
Share issue costs	235,000	319,000
Research and development deductions and credits	750,000	151,000
Operating loss carryforwards	2,624,000	1,451,000
Total future tax assets	3,501,000	2,113,000
Valuation allowance	(3,501,000)	(2,113,000)
Total future tax assets	—	—
Future income tax liabilities:		
Intangible assets	—	85,000
Net future income tax liabilities	—	85,000

The potential income tax benefits relating to the net future tax assets have not been recognized in the consolidated financial statements as their realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. Accordingly, no net future tax assets have been recognized as at March 31, 2008 and 2007.

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expenses using a 33.47% statutory tax rate [March 31, 2007 – 34.12%] is:

	2008	2007
	\$	\$
Income taxes at statutory rates	(2,034,000)	(1,537,709)
Expenses not deductible for tax purposes	119,000	202,000
Benefit of non-capital losses not recognized	1,793,000	1,056,709
Others	3,000	
Impact of tax rate change	—	57,000
Foreign tax rate difference	34,000	69,000
Future income tax recovery	(85,000)	(153,000)

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13. SEGMENTED INFORMATION

The Company operates primarily in one business segment with substantially all of its consolidated assets located in Canada and operations located in Canada.

14. RELATED PARTY TRANSACTIONS

During the year ended March 31, 2008, the Company incurred \$130,819 [2007 - \$204,901] of expenditures for services provided by related parties. These transactions were incurred in the normal course of business and recorded at their exchange amounts. Details of related party transactions during the years ended March 31, 2008 and 2007 are summarized as follows:

	March 31, 2008	March 31, 2007
	\$	\$
Consulting services provided by directors	3,186	48,729
Consulting services provided by a financial consulting firm of which a director is an executive	—	14,123
Finder fees, inclusive of issuance of 29,412 common shares, associated with IL Therapeutics Inc. to a financial consulting firm of which a director is an executive	—	100,000
Research services provided by a consulting firm of which a director is the principal	1,000	—
Research services provided by a consulting firm of which an officer is the principal	120,988	6,512
Research services provided by a university laboratory of which an officer is a professor	5,645	35,537
	130,819	204,901