

Consolidated Financial Statements

**Pacgen Biopharmaceuticals Corporation**

(a development stage enterprise)

(Expressed in Canadian dollars)

March 31, 2009 and 2008



## AUDITORS' REPORT

To the Shareholders of  
**Pacgen Biopharmaceuticals Corporation**

We have audited the consolidated balance sheets of **Pacgen Biopharmaceuticals Corporation** (a development stage enterprise) (the "Company") as at March 31, 2009 and 2008, and the consolidated statements of operations and comprehensive loss and cash flows for each of the years in the two year period ended March 31, 2009 and for the period from April 23, 2004 (inception) to March 31, 2009, and the consolidated statements of shareholders' equity for years ended March 31, 2009 and 2008. These consolidated 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 Canadian generally accepted auditing standards which 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at March 31, 2009 and 2008 and the consolidated results of its operations and its cash flows for the years then ended, and for the period from April 23, 2004 (inception) to March 31, 2009 in accordance with Canadian generally accepted accounting principles.

*Ernst & Young LLP*

Vancouver, Canada,  
July 10, 2009.

Chartered Accountants

**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)

	<b>March 31, 2009</b>	<b>March 31, 2008</b>
	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents <i>[note 7]</i>	<b>308,871</b>	1,438,691
Amounts receivable	<b>15,155</b>	12,800
Prepaid expenses and other	<b>515,619</b>	469,307
<b>Total current assets</b>	<b>839,645</b>	1,920,798
Deferred acquisition costs	<b>3,775</b>	—
Property and equipment <i>[note 8]</i>	<b>67,874</b>	101,236
Intangible assets <i>[note 9]</i>	<b>765,229</b>	1,002,203
<b>Total assets</b>	<b>1,676,523</b>	3,024,237
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	<b>911,688</b>	1,378,733
Other payable <i>[note 10]</i>	<b>625,423</b>	—
Convertible debentures <i>[note 11]</i>	<b>318,831</b>	—
Current portion of deferred leasehold inducement	<b>6,916</b>	6,916
	<b>1,862,858</b>	1,385,649
Convertible debentures <i>[note 11]</i>	<b>213,000</b>	—
Deferred leasehold inducement	<b>3,459</b>	10,375
<b>Total liabilities</b>	<b>2,079,317</b>	1,396,024
Commitments and contingencies <i>[notes 13 and 14]</i>		
<b>Shareholders' equity (deficit)</b>		
Share capital <i>[note 12]</i>		
Issued and outstanding:		
Common shares <i>[note 12(a)]</i>	<b>13,012,118</b>	13,012,118
Preferred shares <i>[note 12(b)]</i>	—	—
Contributed surplus <i>[notes 11 and 12(e)]</i>	<b>1,415,409</b>	1,163,776
Deficit	<b>(14,830,321)</b>	(12,547,681)
<b>Total shareholders' equity (deficit)</b>	<b>(402,794)</b>	1,628,213
<b>Total liabilities and shareholders' equity</b>	<b>1,676,523</b>	3,024,237

*See accompanying notes*

On behalf of the Board:

/s/ Telvin Ju  
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, 2009 \$	Year ended March 31, 2008 \$	Cumulative from Inception to March 31, 2009 \$
<b>EXPENSES</b>			
Research and development <i>[note 6]</i>	1,451,884	3,480,523	7,782,314
Research and development expense recovery <i>[notes 6 and 10]</i>	(865,287)	—	(865,287)
	<b>586,597</b>	3,480,523	6,917,027
General and administration	1,052,414	1,901,567	6,079,382
Stock based compensation <i>[note 12(e)]</i>	160,687	346,348	1,087,860
Amortization	263,816	269,245	797,319
	<b>2,063,514</b>	5,997,683	14,881,588
<b>OTHER</b>			
Interest and other income	39,123	94,838	263,929
Loss on disposal of property and equipment	(6,520)	(9,089)	(15,609)
Foreign exchange losses	(251,729)	(147,778)	(435,053)
	<b>(219,126)</b>	(62,029)	(186,733)
Loss before income taxes	<b>(2,282,640)</b>	(6,059,712)	(15,068,321)
Future income tax recovery <i>[note 15]</i>	—	85,000	238,000
<b>Net loss and comprehensive loss for the period</b>	<b>(2,282,640)</b>	<b>(5,974,712)</b>	<b>(14,830,321)</b>
<b>Basic and diluted loss per common share</b>	<b>(0.06)</b>	<b>(0.19)</b>	
<b>Weighted average number of common shares outstanding</b>	<b>35,144,693</b>	<b>30,711,416</b>	

*See accompanying notes*

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(expressed in Canadian dollars)

	Year ended March 31, 2009 \$	Year ended March 31, 2008 \$	Cumulative from Inception to March 31, 2009 \$
<b>OPERATING ACTIVITIES</b>			
Loss for the period	(2,282,640)	(5,974,712)	(14,830,321)
Add items not affecting cash:			
Accretion of convertible debentures	8,277	—	8,277
Amortization	263,816	269,245	797,319
Deferred leasehold inducement	(6,916)	(1,153)	(8,069)
Future income tax recovery	—	(85,000)	(238,000)
Loss on disposal of property and equipment	—	9,089	9,089
Stock based compensation	160,687	346,348	1,087,860
Unrealized foreign exchange loss	214,934	87,936	302,870
Write-off of assets	6,520	5,548	29,887
	<b>(1,635,322)</b>	<b>(5,342,699)</b>	<b>(12,841,088)</b>
Changes in non-cash working capital items relating to operations:			
Amounts receivable	(2,355)	119,260	128,340
Prepaid expenses and other	48,428	384,386	(526,634)
Accounts payable and accrued liabilities	(788,951)	138,134	563,789
Other payable	637,655	—	637,655
<b>Cash used in operating activities</b>	<b>(1,740,545)</b>	<b>(4,700,919)</b>	<b>(12,037,938)</b>
<b>INVESTING ACTIVITIES</b>			
Acquisition of IL Therapeutics Inc.	—	—	1,237,089
Deferred acquisition costs	(3,775)	—	(3,775)
Proceeds from disposal of property and equipment	—	5,775	5,775
Purchase of property and equipment	—	(19,485)	(179,202)
Purchase of intangible assets	—	—	(59,743)
Leasehold inducement	—	18,444	18,444
<b>Cash provided by (used in) investing activities</b>	<b>(3,775)</b>	<b>4,734</b>	<b>1,018,588</b>
<b>FINANCING ACTIVITIES</b>			
Issuance of common shares for cash, net of share issuance costs	—	747,510	8,887,292
Issuance of preferred shares for cash, net of share issuance costs	—	—	1,131,593
Issuance of convertible debentures for cash	614,500	—	614,500
Advance from related party	—	—	694,836
<b>Cash provided by financing activities</b>	<b>614,500</b>	<b>747,510</b>	<b>11,328,221</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1,129,820)</b>	<b>(3,948,675)</b>	<b>308,871</b>
Cash and cash equivalents, beginning of period	1,438,691	5,387,366	—
<b>Cash and cash equivalents, end of period</b>	<b>308,871</b>	<b>1,438,691</b>	<b>308,871</b>
<b>Other supplemental cash flow information</b>			
Preferred shares issued for technology [note 9(b)]	—	—	918,876
Common shares issued for technology [note 9(b)]	—	—	1,561,124
Preferred shares issued to agent as compensation	—	—	52,544
Common shares issued to agent as compensation [note 12(a)(i)]	—	21,546	151,546
Common shares issued to settle related party advance	—	—	718,836

See accompanying notes

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(expressed in Canadian dollars)

	Common Shares		Preferred Shares		Contributed	Deficit	Total
	Number	Amount	Number	Amount	Surplus		
		\$		\$	\$		
<b>Balance, March 31, 2007</b>	<b>30,521,960</b>	<b>12,286,556</b>	—	—	<b>795,480</b>	<b>(6,572,969)</b>	<b>6,509,067</b>
Issued for cash pursuant to a private placement [note 12(a)(i)]	4,515,003	747,510	—	—	—	—	747,510
Value of share purchase warrant pursuant to a private placement [note 12(a)(i)]	—	(2,535)	—	—	2,535	—	—
Compensation to private placement agent	107,730	(19,413)	—	—	19,413	—	—
Stock based compensation [note 12(e)]	—	—	—	—	346,348	—	346,348
Net loss for the period	—	—	—	—	—	(5,974,712)	(5,974,712)
<b>Balance, March 31, 2008</b>	<b>35,144,693</b>	<b>13,012,118</b>	—	—	<b>1,163,776</b>	<b>(12,547,681)</b>	<b>1,628,213</b>
Equity component of a private placement of convertible debentures [note 11]	—	—	—	—	90,946	—	90,946
Stock based compensation [note 12(e)]	—	—	—	—	160,687	—	160,687
Net loss for the period	—	—	—	—	—	(2,282,640)	(2,282,640)
<b>Balance, March 31, 2009</b>	<b>35,144,693</b>	<b>13,012,118</b>	—	—	<b>1,415,409</b>	<b>(14,830,321)</b>	<b>(402,794)</b>

See accompanying notes

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

March 31, 2009 and 2008

(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 technology transfer company focused on the commercial development of novel therapeutic drug candidates up to Phase II, proof of concept efficacy in human. The Company identifies innovative therapeutic drug candidates globally, and develops these drug candidates in accordance to the US Food and Drug Administration regulatory standards to feed the product development pipelines of the pharmaceuticals industry.

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year. Realization values may be substantially different from the carrying values as shown and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classifications of assets and liabilities should the Company be unable to continue as a going concern. As of March 31, 2009, the Company has not generated any revenue from its operations and has accumulated a deficit of \$14,830,321 (March 31, 2008 - \$12,547,681). Therefore, the Company is considered to be in the development stage. The Company has a working capital deficiency of \$1,023,213 as of March 31, 2009 which is not sufficient to sustain operations over the next year and the Company may be unable to continue realizing its assets and discharge its obligations in the normal course, all of which casts substantial doubt about the Company's ability to continue as a going concern. While the Company has been successful in securing financings in the past, there is no assurance that it will be able to do so in the future. Accordingly, these financial statements do not give effect to adjustments, if any, that would be necessary should the Company be unable to continue as a going concern. If the going concern assumption was not used then the adjustments required to report the Company's assets and liabilities on a liquidation basis could be material to these financial statements.

The recent global financial market downturn has led to an overall tightening in the credit markets and a substantial reduction in capital available to companies in the development stage. Smaller life science technology companies which are generally viewed as higher risk investments have been significantly affected. The Company undertook a comprehensive review of its product development programs, operations and projected cash requirements with the view of conserving cost and deferring cash outflows. As a result, the Company implemented a cost management program, ceased research and development activities and focused its operations in business development to secure collaborative partners for its drug candidates. The Company undertook a number of financing initiatives including a small bridge financing and negotiation with its major vendors for defer payments.

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**1. NATURE OF OPERATIONS AND GOING CONCERN (cont'd.)**

On January 30, 2009, the Company announced that it intended to offer, through one or more tranches of closings of a non-brokered private placement, convertible debentures in an aggregate principal amount of up to approximately \$610,000 (the "Offering"). The Company closed this Offering in two tranches in February 2009 and March 2009 for an aggregate principal amount of \$614,500, as described in *note 11*. In February 2009, the Company terminated all of its employees except for certain key personnel who have agreed to provide services as consultants and be compensated through stock options.

On March 6, 2009, the Company finalized its negotiation with a vendor to settle its outstanding account of approximately US\$1.3 million (\$1.65 million). The Company received a credit note and recovered approximately US\$604,000 (\$747,000) of research and development expenditures from this vendor. For the remaining balance of US\$708,000 (\$893,000), the Company made an initial payment of US\$128,000 (\$157,000) and agreed to pay the balance of US\$580,000 (\$731,000) by installments, as described in *note 10*. Management has been in constant communication with this vendor to keep them apprised of the Company's developments.

The Company has also reviewed strategic alternatives to leverage its technology portfolio and to enhance its ability to raise capital. As part of these efforts, the Company signed a share purchase agreement with the shareholders of Xphase Pharmaceuticals Inc. ("Xphase") in June 2009, as described in *note 18*. Xphase, a privately held pharmaceutical company, has the right to acquire the exclusive global rights, excluding China, of AF-05, a novel anti-anxiety drug candidate currently in Phase I clinical trial in China. Xphase also provides consulting and project management services to assist small to medium pharmaceutical and biotechnology companies globally.

Pursuant to the share purchase agreement, the Company agreed to issue 3 million common shares of the Company to Xphase shareholders in exchange for 100% ownership of Xphase as well as management services of Xphase principals. Upon the achievement of certain pre-defined business development milestones, Xphase shareholders will be entitled to an additional 3.5 million common shares of the Company. Following the acquisition of Xphase, the Company has positioned itself to become a global life science technology transfer company focused on the commercial development of novel therapeutic drug candidates up to Phase II human proof of concept.

The Company is currently seeking additional funding to finance its operations and obligations. Management is considering all possible financing alternatives, including equity financing, debt financing, joint-venture, corporate collaboration and licensing arrangement.

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

March 31, 2009 and 2008

(expressed in Canadian dollars)

**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.

**[a] Consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, IL Therapeutics Inc. incorporated in Canada under the Canada Business Corporations Act. The consolidated financial statements for fiscal year ended March 31, 2008 also include accounts of Pacgen Biopharmaceuticals Corporation (Taiwan Branch) ("Pacgen Taiwan") which was wound up in March 2008. All significant inter-company balances and transactions have been eliminated on consolidation.

**[b] 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 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.

**[c] 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.

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**[d] 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, 2009 and 2008, cash and cash equivalents consisted of cash on deposit with banks, as well as subscription amounts received in trust accounts following closing of a financing.

**[e] 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
Office furniture and equipment	20% declining balance

**[f] 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.

**[g] 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 long-lived assets, 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.

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**NOTES TO CONSOLIDATED  
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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**[h] Convertible debentures**

The Company's convertible debentures are segregated into their debt and equity components at the date of issuance, in accordance with the substance of the contractual agreements. The debt component of the instruments is classified as a liability, and recorded at the present value of the Company's obligations to make future interest payments and settle the redemption value of the instruments. The carrying value of the debt component is accreted to the original face value of the instruments, over the term of the convertible debentures, using the effective interest rate method. The value of the conversion option makes up the equity component of the instruments. The conversion option is recorded using the residual method. Transaction costs associated with convertible debentures financing are expensed in the period in which they are incurred.

**[i] 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.

**[j] 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.

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.

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**NOTES TO CONSOLIDATED  
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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**[k] 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.

**[l] Investment tax credits**

The Company recognizes tax credits for qualifying research and development costs when there is reasonable assurance of realization of such credits. The Company accounts for investment credits relating to research and development expenses as a reduction of such expenses and those relating to capital expenditures as reduction of the cost of the assets acquired. No investment tax credits have been recorded in these financial statements as there is no reasonable assurance of realization.

**[m] Stock-based compensation**

The Company grants stock options to employees, directors, and consultants pursuant to a stock option plan described in *note 12(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.

**[n] 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 12* are anti-dilutive for all periods presented.

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**NOTES TO CONSOLIDATED  
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**3. CHANGES IN ACCOUNTING POLICIES**

**[a] General Standards of Financial Statement Presentations**

In May 2007, the Canadian Accounting Standards Board (the “AcSB”) amended CICA Handbook Section 1400, “*General Standards of Financial Statement Presentation*”, to change the guidance related to management’s responsibility to assess the ability of the entity to continue as a going concern.

The main features of the changes are as follows:

- (i) management is required to make an assessment of an entity’s ability to continue as a going concern;
- (ii) in making its assessment, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date;
- (iii) financial statements must be prepared on a going concern basis unless management either intends to liquidate the entity, to cease trading or cease operations, or has no realistic alternative but to do so;
- (iv) disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern; and
- (v) when financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason the entity is not regarded as a going concern.

This section became effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company adopted these standards commencing April 1, 2008. The new disclosure requirements pertaining to this section are contained in *note 1* of these consolidated financial statements.

**[b] Capital Disclosures**

The AcSB issued Section 1535, “*Capital Disclosures*”. This section establishes standards for disclosing information about an entity’s capital and how it is managed in order that a user of the financial statements may evaluate the entity’s objectives, policies and processes for managing capital. This section became effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company adopted these standards commencing April 1, 2008. The adoption of these new standards did not have a material impact on the Company’s consolidated financial statements. The new disclosure requirements pertaining to this section are contained in *note 4* of these consolidated financial statements.

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

**[c] Financial Instruments – Disclosure and Presentation**

The AcSB issued two new sections in relation to financial instruments: Section 3862, “*Financial Instruments – Disclosure*” and Section 3863, “*Financial Instruments – Presentation*”. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new presentation standard carries forward the former presentation requirements. Both sections became effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company adopted these standards commencing April 1, 2008. The adoption of these new standards did not have a material impact on the Company’s consolidated financial statements. The new disclosure requirements pertaining to these sections are contained in *note 5* of these consolidated financial statements.

**[d] New Accounting Pronouncements**

In February 2008, the AcSB confirmed that Canadian GAAP for public companies will be converged with International Financial Reporting Standards (“IFRS”) for accounting periods commencing on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are some significant differences on recognition, measurement and disclosures. 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.

In January 2009, the CICA issued Section 1601 “*Consolidations*” and Section 1602 “*Non-controlling Interests*”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are applicable to interim and annual financial statements of the Company beginning on January 1, 2011. The Company is in the process of evaluating the impact of these standards.

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

**[d] New Accounting Pronouncements (cont'd.)**

In January 2009, the CICA issued Section 1582 "*Business Combinations*" replacing Section 1581 "*Business Combinations*". The new section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The section is applicable to the annual and interim financial statements of the Company beginning on or January 1, 2011, with early adoption permitted. The Company is in the process of evaluating the impact of this standard.

In January 2009, the CICA issued EIC 173 "*Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*". This guidance requires that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to the Company's 2009 fiscal year with retrospective application without restatement of prior periods. The Company is in the process of evaluating the impact of this new guidance.

**4. CAPITAL DISCLOSURE**

The Company's objectives when managing capital are to ensure its ability to continue as a going concern in order to pursue the development of its drug candidates and the ultimate sale or out-license of these drug candidates to pharmaceutical companies. The Company attempts to maximize return to shareholders by minimizing shareholder dilution and, when possible, utilizing non-dilutive funding arrangements, such as interest income and collaborative partnership arrangements.

The Company includes convertible debentures and equity comprised of issued share capital, contributed surplus and deficit in the definition of capital. Other than the recent issuance of convertible debentures, the Company has financed its capital requirements primarily through share issuances since inception.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and risk characteristics of the underlying assets. The Company may issue new shares or raise debt. The Company is not subject to any externally imposed capital requirements and the overall strategy with respect to capital management remains unchanged from the year ended March 31, 2008.

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**5. FINANCIAL INSTRUMENTS AND RISK**

The Company's financial instruments consist of cash and cash equivalents, amounts receivable, accounts payable and accrued liabilities, other payable and convertible debentures. The fair value of these instruments approximates their carrying amount due to their immediate or short-term maturity. Other payable and convertible debentures were recorded at fair value on the date of issuance. The Company has classified its financial instruments as follows:

<b>Financial Instrument</b>	<b>Classification</b>	<b>Measurement</b>
Cash and cash equivalents	Held for trading	Fair value
Amounts receivable	Loans and receivables	Amortized cost using the effective interest method
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost using the effective interest method
Other payable	Other financial liabilities	Amortized cost using the effective interest method
Convertible debentures	Other financial liabilities	Amortized cost using the effective interest method

The Company did not have any held-to-maturity or available-for-sale financial instruments, nor did it acquire or hold any derivative products during the years ended March 31, 2009 and 2008.

The Company's financial instruments are exposed to certain financial risks, including credit risk, interest rate risk, currency risk and liquidity risk:

**[a] Credit risk**

Credit risk is the risk of a financial loss to the Company if counterparty to a financial instrument fails to meet its contractual obligations, and arises principally of cash and cash equivalents. The Company has investment policies to mitigate against the deterioration of principal, to enhance the Company's ability to meet its liquidity needs and to optimize yields within those parameters. These investment policies limit the investing of excess funds to liquid term deposits with banks and government guaranteed securities with maturities of two years or less.

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**5. FINANCIAL INSTRUMENTS (cont'd.)**

**[b] Interest rate risk**

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in the market interest rates. The Company is exposed to interest rate risk on its convertible debentures and other payables which bear floating interest rates. The Company estimates that one percent increase in the interest rate would increase the net loss and cash used in operations for the year ended March 31, 2009 by \$569. An opposite impact would have occurred to net loss and cash used in operations had interest rate decreased by one percent. Fluctuations in the market interest rates had limited impact on the Company's interest expense in the year ended March 31, 2009 given the timing of the issuance of convertible debentures in the fourth quarter. The Company had no exposure to interest rate fluctuations on liabilities in the preceding fiscal year. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

The Company is also exposed to interest rate risk on its cash and cash equivalents that earn interest at market interest rates. Given the level of cash and cash equivalents held by the Company during the year ended March 31, 2009, fluctuations in the market interest rates had no significant impact on its interest income.

**[c] Currency risk**

The Company is exposed to the financial risk related to the fluctuation of foreign exchanges rates. The Company operates primarily within Canada although a portion of its expenses are incurred in United States dollars ("US dollar"). The Company has not entered into foreign exchange derivative contracts. A significant change in the currency exchange rates between the Canadian dollar relative to the US dollar could have an effect on the Company's results of operations, financial position or cash flows.

As at March 31, 2009 and 2008, the Company had the following assets and liabilities denominated in US dollars:

	<b>March 31, 2009 US\$</b>	<b>March 31, 2008 US\$</b>
Cash and cash equivalents	<b>14,802</b>	8,818
Prepaid expenses	<b>382,261</b>	407,261
Accounts payable and accrued liabilities	<b>413,679</b>	1,200,023
Other payable	<b>495,856</b>	—
	<b>1,306,598</b>	1,616,102

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**5. FINANCIAL INSTRUMENTS (cont'd.)**

**[c] Currency risk (cont'd)**

Based on the above net exposures as at March 31, 2009, and assuming that all other variables remain constant, a 5% appreciation or deterioration of the Canadian dollar against the US dollar would result in a decrease or increase of \$32,319 (March 31, 2008 - \$35,455) in the Company's net loss and comprehensive loss.

**[d] Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its obligations as they come due. The Company's exposure to liquidity risk is dependent on purchasing commitments and obligations and raising of funds to meet commitments and sustain operations. The Company manages liquidity risk by continuously monitoring its actual and forecasted working capital requirements, and actively managing its financing activities.

As of March 31, 2009, the Company had a working capital deficiency of \$1,023,213 (March 31, 2008 - \$535,149). The Company is currently seeking additional capital to meet its immediate obligations and to finance its operations. Management is considering all financing alternatives, including equity financing, debt financing, joint-venture, corporate collaboration and licensing arrangement.

**6. RESEARCH AND DEVELOPMENT EXPENSES**

<b>Project</b>	<b>Year ended March 31, 2009 \$</b>	<b>Year ended March 31, 2008 \$</b>	<b>Cumulative from Inception to March 31, 2009 \$</b>
<b>PAC-113 [2005 – 2009]</b>			
Expense	<b>1,154,902</b>	2,302,548	5,469,146
Recovery [note 10]	<b>(865,287)</b>	—	(865,287)
	<b>289,615</b>	2,302,548	4,603,859
<b>PAC-G31P [2007 – 2009]</b>	<b>272,306</b>	1,146,834	2,099,603
Other Projects	<b>24,676</b>	31,141	213,565
	<b>586,597</b>	3,480,523	6,917,027

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**7. CASH AND CASH EQUIVALENTS**

As at March 31, 2009, cash and cash equivalents include \$nil [2008 - \$900,000] of Canadian dollars term deposits with a weighted average interest rate of nil% [2008 - 3.84%], and \$250,000 [2008 - \$Nil] of subscription amounts received in trust accounts following the closing of a financing.

**8. PROPERTY AND EQUIPMENT**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
	\$	\$	\$
<b>March 31, 2009</b>			
Computer equipment and software	46,304	33,080	13,224
Leasehold improvement	41,346	14,131	27,215
Office furniture and equipment	43,718	16,283	27,435
	<b>131,368</b>	<b>63,494</b>	<b>67,874</b>
<b>March 31, 2008</b>			
Computer equipment and software	55,280	25,450	29,830
Leasehold improvement	41,346	8,083	33,263
Office furniture and equipment	50,456	12,313	38,143
	147,082	45,846	101,236

During the year ended March 31, 2009, amortization was \$263,816 [2008 - \$269,245].

**9. INTANGIBLE ASSETS**

	<b>March 31, 2009</b>	<b>March 31, 2008</b>
	\$	\$
<b>Technology, licenses and rights</b>		
Cost	1,477,151	1,477,151
Accumulated amortization	711,922	474,948
	<b>765,229</b>	<b>1,002,203</b>

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**9. INTANGIBLE ASSETS (cont'd.)**

- [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"). In consideration for the Demegen Sublicense, the Company paid Demegen an initial license fee of US\$50,000.

The Company subsequently entered into an amendment agreement with Demegen, on January 2, 2006, 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 price of \$0.60 per share and 500,000 share purchase options with a fair value of \$30,000 with an exercise price of \$2.25 per share. These warrants expired unexercised on December 7, 2008.

The initial fees at the exchange amount of \$59,472, the fair value of the common shares issued of \$480,000 and the fair value of the share purchase options granted of \$30,000 had been capitalized as technology license and rights and amortized on a straight line basis over ten years. The net book value of the Demegen Sublicense as of March 31, 2009 was \$385,821 (March 31, 2008 - \$442,795).

- [b] 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 (the "PAC-G31P Technology"). 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. The ILT Acquisition was accounted for as an asset acquisition and the purchase price was allocated to ILT's identifiable assets and liabilities.

The share purchase price allocated to the acquired PAC-G31P Technology of \$907,409 had been capitalized as technology license and rights and amortized on a straight line basis over five years. The net book value of the acquired technology as of March 31, 2009 was \$379,408 (March 31, 2008 - \$559,408).

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**10. OTHER PAYABLE**

On March 6, 2009, the Company finalized its settlement arrangement with a vendor for its outstanding accounts of approximately US\$1.3 million (\$1.65 million). As part of this settlement, the Company received from this vendor a credit note of approximately US\$604,000 (\$747,000) as a research and development expense recovery in the year ended March 31, 2009. For the remaining balance of US\$708,000 (\$893,000), the Company made an initial payment of US\$128,000 (\$157,000) and agreed to pay the balance amount of US\$580,000 (\$731,000) by three minimum installments.

The minimum payments of US\$150,000 (\$189,000), US\$150,000 (\$189,000) and US\$280,000 (\$353,000) are due on July 15, 2009 [note 18], October 15, 2009 and December 30, 2009, respectively. Pursuant to the settlement agreement, should the Company successfully complete a transaction or multiple transactions which give rise to accumulated proceeds equal to or greater than US\$500,000 (approximately \$631,000), the Company is obligated to make the first payment immediately. The Company is entitled to earlier repayment by giving a 10 days notice.

Unless all minimum payments are made in accordance to the settlement agreement, the Company is obligated to pay interest at a rate of six percent above the average daily prime interest rate of a chartered bank on amounts due and outstanding from the respective due dates until paid [note 18]. All interest payments are due and payable in full on December 30, 2009.

**11. CONVERTIBLE DEBENTURES**

On January 30, 2009, the Company announced that it intended to offer, through one or more tranches of closings of a non-brokered private placement, convertible debentures in an aggregate principal amount of up to approximately \$610,000 (the "Offering"). The Company closed this Offering in two tranches in February 2009 and March 2009 for an aggregate principal amount of \$614,500.

<b>Maturity Date</b>	<b>Principal Amount \$</b>
February 3, 2010 <sup>(1)</sup>	364,500
April 14, 2010 <sup>(2)</sup>	250,000
	<b>614,500</b>

<sup>(1)</sup> Include debentures of \$243,000 held by director or officer of the Company (the "Insiders").

<sup>(2)</sup> The second tranche of the Offering was closed on March 30, 2009 with final completion on April 14, 2009.

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**11. CONVERTIBLE DEBENTURES (cont'd.)**

The convertible debentures will bear interest from the date of issuance at a rate of prime plus 4% per annum and will mature one year from the date of issuance. The principal amount plus any accrued interest will be repayable in cash upon the earlier of (i) maturity or (ii) closing of a merger or a financing transaction with a value to the Company of at least US\$1 million (approximately \$1.26 million). Early redemption by the Company is allowed upon 30 days written notice.

All debenture holders acknowledged and agreed that, prior to maturity, they may not demand from the Company payment of the principal amount, interest or any outstanding portion thereof. At anytime prior to maturity, the debenture holders have the rights to convert these convertible debentures into units of the Company (the "Units") at a conversion price of \$0.10 per Unit upon 10 days written notice. Each Unit will consist of one common share of the Company (a "Common Share") and one common share purchase warrant (a "Warrant"), each Warrant entitling a non-insider holder to purchase one Common Share at an exercise price of \$0.10 per Common Share at any time prior to 24 months following the date of issuance of the Warrant upon conversion of the convertible debentures. Each Warrant comprising the Units issuable upon conversion of convertible debentures issued to insiders of the Company entitles a holder to purchase one Common Share at an exercise price of \$0.10 per Common Share and will expire upon the earlier of the maturity date of the convertible debentures and the date that is 24 months following the date of issuance of the Warrants upon conversion of the convertible debentures. Prior to conversion, in the event that the share capital of the Company has been restructured or a business combination involving the Company has occurred (the "Fundamental Change"), the debenture holders are entitled to receive the equivalent new securities as if the debenture conversions had occurred prior to the occurrence of the Fundamental Change.

The Company is not restricted to obtaining other financing or issuing shares subsequent to the issuance of these convertible debentures.

The Company has classified the convertible debentures into its components being financial liabilities and equity components, respectively. The fair value of the liability component was estimated by discounting the future cash stream of debt at a discount rate of 25% which represents the estimated borrowing rate available for the Company for similar debentures having no conversion rights. The residual value was allocated to the equity component. The amount of total proceeds allocated to the liability components and equity components (contributed surplus) at the issuance were:

<b>Allocation</b>	<b>Amount</b>
	<b>\$</b>
Face value	614,500
Contributed surplus	(90,946)
	523,554
Short-term portion	(310,554)
	213,000

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**11. CONVERTIBLE DEBENTURES (cont'd.)**

The Company incurred legal and professional fees of \$30,097 associated with the financing. These financing costs together with an interest expense of \$11,912 associated with the convertible debentures were charged as expenses during the year ended March 31, 2009.

**12. SHARE CAPITAL**

**[a] Common shares**

	<b>Number of Shares</b>	<b>Amount \$</b>
<b>Authorized</b>		
Unlimited number of common shares without par value		
<b>Balance, March 31, 2007</b>	<b>30,521,960</b>	<b>12,286,556</b>
Issued for cash pursuant to a private placement [i]	4,622,733	725,562
<b>Balance, March 31, 2008 and 2009</b>	<b>35,144,693</b>	<b>13,012,118</b>

[i] 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 costs of \$155,490.

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**12. SHARE CAPITAL (cont'd.)**

**[b] Preferred shares**

The authorized share capital of the Company also consists of an unlimited number of preferred shares without par value. As of March 31, 2009 and 2008, there were no preferred shares issued and outstanding.

**[c] Common share purchase warrants**

	<b>Number</b>	<b>Weighted Average Exercise Price \$</b>
<b>Balance, March 31, 2007</b>	<b>7,936,401</b>	<b>1.21</b>
Expired on December 7, 2007	(3,394,393)	1.30
Issued on March 17, 2008 [note 12(a)(i)]	4,515,003	0.30
Issued on March 17, 2008 [note 12(a)(i)]	107,730	0.30
Issued on March 17, 2008 [note 12(a)(i)] <sup>(1)</sup>	34,200	0.22
<b>Balance, March 31, 2008</b>	<b>9,198,941</b>	<b>0.72</b>
Expired on December 7, 2008	(2,748,906)	1.16
Expired on December 7, 2008	(1,250,000)	1.16
Expired on December 7, 2008	(543,102)	1.05
<b>Balance, March 31, 2009</b>	<b>4,656,933</b>	<b>0.30</b>

<b>Date of Expiry</b>	<b>Exercise Price</b>	<b>Number of Warrants</b>
March 16, 2013 [note 12(a)(i)]	\$0.30	4,622,733
March 16, 2010 [note 12(a)(i)] <sup>(1)</sup>	\$0.22	34,200
<b>Balance, March 31, 2009</b>	<b>\$0.30</b>	<b>4,656,933</b>

<sup>(1)</sup> 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 4,691,133 common share purchase warrants outstanding, at an average exercise price of \$0.30, as of March 31, 2009.

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**12. SHARE CAPITAL (cont'd.)**

**[d] Share purchase options**

	<b>Number</b>	<b>Weighted Average Exercise Price \$</b>
<b>Balance March 31, 2007 and 2008</b>	<b>500,000</b>	<b>2.25</b>
Granted	—	—
Expired [note 9(a)]	(500,000)	2.25
<b>Balance, March 31, 2009</b>	<b>—</b>	<b>—</b>

**[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.

During the years ended March 31, 2009 and 2008, the Company granted certain options and also cancelled certain options upon the option holders ceased to become eligible persons (the "Eligible Persons") as defined in the Stock Option Plan. Options granted to former employees who continued to perform services as consultants to the Company after their employment were kept, provided that such option holders remained as Eligible Persons. Details of stock option transactions are summarized as follows:

	<b>Number</b>	<b>Weighted Average Exercise Price \$</b>
<b>Balance, March 31, 2007</b>	<b>2,499,000</b>	<b>1.02</b>
Granted	229,000	0.70
Forfeited or cancelled	(94,000)	1.02
<b>Balance, March 31, 2008</b>	<b>2,634,000</b>	<b>0.99</b>
Granted	175,000	0.26
Forfeited or cancelled	(995,667)	0.79
<b>Balance, March 31, 2009</b>	<b>1,813,333</b>	<b>0.99</b>

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**12. SHARE CAPITAL (cont'd.)**

**[e] Stock options (cont'd.)**

At March 31, 2009, stock options to executive officers and directors, employees, consultants and clinical advisory board members were outstanding as follows:

<b>Options Outstanding</b>				<b>Options Exercisable</b>	
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 (\$)
\$0.26 - \$0.45	40,000	4.40	0.26	40,000	0.26
\$0.50 - \$0.85	393,333	6.04	0.64	306,666	0.64
\$1.00 - \$1.05	530,000	4.04	1.05	520,000	1.05
\$1.10 - \$1.16	850,000	5.47	1.16	720,000	1.16
	<b>1,813,333</b>	<b>5.05</b>	<b>0.99</b>	<b>1,586,666</b>	<b>0.99</b>

As of March 31, 2009, stock options to employees, officers, directors, consultants and scientific advisory board members were outstanding as follows:

<b>Date of Expiry</b>	<b>Exercise Price</b>	<b>Number of Options Outstanding</b>	<b>Number of Options Exercisable</b>
August 22, 2014	\$0.50	10,000	10,000
August 22, 2011	\$1.05	150,000	150,000
August 22, 2014	\$1.05	210,000	200,000
August 22, 2014	\$1.16	730,000	630,000
March 6, 2012	\$1.05	100,000	100,000
March 6, 2015	\$1.05	50,000	50,000
March 6, 2015	\$1.16	120,000	90,000
March 27, 2015	\$0.65	233,333	233,333
May 31, 2012	\$1.05	20,000	20,000
May 31, 2015	\$0.63	150,000	63,333
Aug 28, 2013	\$0.26	40,000	40,000
<b>Balance, March 31, 2009</b>		<b>1,813,333</b>	<b>1,586,666</b>

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**12. SHARE CAPITAL (cont'd.)**

**[e] Stock options (cont'd.)**

The fair value of the stock options granted was estimated using the Black-Scholes valuation model with the following assumptions:

Volatility	88.90 – 136.31%
Expected life of options	2 – 5 years
Dividend yield	0.00%
Risk free interest rate	1.07 – 4.00%

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

	<b>March 31 2009</b>	<b>March 31 2008</b>
	\$	\$
Employees	<b>116,487</b>	331,853
Non-employees	<b>44,200</b>	14,495
	<b>160,687</b>	346,348

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.

**13. COMMITMENTS**

**[a] Operating leases**

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

	\$
2010	101,372
2011	52,454
2012	3,537
2013	—
2014	—
	<b>157,363</b>

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**13. 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 \$2,923,950 for the fiscal year ending March 31, 2010. Of these commitments, \$490,966 are non-cancellable and \$2,432,984 are cancellable for fiscal year ending March 31, 2010.

**[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 9(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. \$334,907 has been paid to date. The Company is committed to provide funding for the remaining balance of \$165,095 by October 15, 2009.

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(expressed in Canadian dollars)

**14. 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.

**15. INCOME TAXES**

At March 31, 2009, 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:

	<b>Federal Investment Tax Credits</b>	<b>Provincial Investment Tax Credits</b>	<b>Non-Capital Losses</b>
	\$	\$	\$
2011	—	—	11,000
2015	—	—	287,000
2016	—	24,000	687,000
2017	—	45,000	—
2018	—	49,000	—
2019	—	15,000	—
2026	43,000	—	—
2027	118,000	—	2,008,000
2028	173,000	—	5,154,000
2029	51,000	—	3,512,000
	<u>385,000</u>	<u>133,000</u>	<u>11,659,000</u>

In addition, the Company has unclaimed tax deductions of approximately \$1,616,373 related primarily to scientific research and experimental development expenditures available to carryforward indefinitely to reduce taxable income of future years.

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

March 31, 2009 and 2008

(expressed in Canadian dollars)

**15. INCOME TAXES (cont'd.)**

Significant components of the Company's future tax assets and liabilities as of March 31, 2009 are shown below:

	<b>2009</b>	<b>2008</b>
	\$	\$
<b>Future tax assets:</b>		
Tax basis in excess of accounting value	<b>10,000</b>	(108,000)
Share issuance costs	<b>156,000</b>	235,000
Research and development deductions and credits	<b>1,086,000</b>	750,000
Write-off of investment in Pacgen Taiwan	<b>\$309,400</b>	—
Operating loss carryforwards	<b>3,031,000</b>	2,624,000
Total future tax assets	<b>4,592,400</b>	3,501,000
Valuation allowance	<b>(4,592,400)</b>	(3,501,000)
Total future tax assets	—	—
<b>Future income tax liabilities:</b>		
Intangible assets	—	—
Net future income tax liabilities	—	—

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, 2009 and 2008.

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expenses using a 30.63% statutory tax rate [March 31, 2008 - 33.47%] is:

	<b>2009</b>	<b>2008</b>
	\$	\$
Income taxes at statutory rates	<b>(699,000)</b>	(2,034,000)
Expenses not deductible for tax purposes	<b>436,000</b>	122,000
Benefit of non-capital losses not recognized	<b>263,000</b>	1,793,000
Foreign tax rate difference	—	34,000
Future income tax recovery	—	(85,000)

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**NOTES TO CONSOLIDATED  
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March 31, 2009 and 2008

(expressed in Canadian dollars)

**16. 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.

**17. RELATED PARTY TRANSACTIONS**

During the year ended March 31, 2009, the Company incurred \$503 [2008 - \$130,819] 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, 2009 and 2008 are summarized as follows:

	<b>March 31, 2009</b>	<b>March 31, 2008</b>
	\$	\$
Consulting services provided by directors	<b>503</b>	3,186
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
Research services provided by a university laboratory of which an officer is a professor	—	5,645
	<b>503</b>	130,819

**18. SUBSEQUENT EVENTS**

On June 8, 2009, the Company signed a share purchase agreement with the shareholders of Xphase Pharmaceuticals Inc. ("Xphase"). Xphase, a privately held pharmaceutical company, has the right to acquire the exclusive global rights, excluding China, of AF-05, a novel anti-anxiety drug candidate currently in Phase I clinical trial in China. Xphase also provides consulting and project management services to assist small to medium pharmaceutical and biotechnology companies globally.

**Pacgen Biopharmaceuticals Corporation**  
(a development stage enterprise)

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

March 31, 2009 and 2008

(expressed in Canadian dollars)

**18. SUBSEQUENT EVENTS (cont'd.)**

Pursuant to the share purchase agreement, the Company agrees to issue 3 million common shares of the Company to Xphase shareholders in exchange for 100% ownership of Xphase as well as management services of Xphase principals. Upon the achievement of certain pre-defined business development milestones, Xphase shareholders will be entitled to an additional 3.5 million common shares of the Company. The Company obtained regulatory approval to complete its acquisition of Xphase in July 2009. Following the acquisition of Xphase, the Company has positioned itself to become a global life-science technology transfer company focused on the commercial development of novel therapeutic drug candidates up to Phase II human proof of concept.

Subsequent to the year ended March 31, 2009, the Company continues to seek additional funding to finance its operations and obligations. The Company's management is considering all possible financing alternatives. 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 or complete a collaborative transaction, it may have to further scale back our operations, consider business combinations or shut down some or all of its operations.

Also subsequent to the year ended March 31, 2009, the Company updated the debtor of other payable [note 10] on the Company's financing progress, and notified that the minimum payment of US\$150,000 due on July 15, 2009 would be deferred. Both parties agreed to maintain close communication on the Company's financing progress. The Company started accrual of interest expenses on July 15, 2009 in accordance to the settlement agreement.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*This management discussion and analysis was performed by management using information available as of July 9, 2009 and should be read in conjunction with our audited consolidated financial statements for the year ended March 31, 2009 and the related notes included thereto. These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). All amounts are expressed in Canadian dollars unless otherwise indicated. Additional information relating to Pacgen Biopharmaceuticals Corporation ("Pacgen" or the "Company") can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com).*

*The forward-looking statements in this discussion regarding our expectations of our future performance, liquidity and capital resources and other non-historical statements include numerous risks and uncertainties, as described in the "Risk Factors" section of our Annual Information Form, which is available on SEDAR at [www.sedar.com](http://www.sedar.com). The words "anticipates", "believes", "estimates", "expects", "intends", "may", "could", "plans", "projects", "will", "would" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results, level of activity, performance or achievements to be materially different from those implied by such statements. Such factors include, among others, our stage of development, lack of product revenues, additional capital requirements, risk associated with completion of clinical trials and obtaining regulatory approval, dependence on collaborative partners, and our ability to protect our intellectual property. We undertake no obligation to revise or update forward looking statement in this discussion whether as a result of new information, future events or otherwise. Accordingly, readers should not place undue reliance on forward looking statements in this discussion.*

### OVERVIEW

We are a life science technology transfer company focused on the commercial development of novel therapeutic drug candidates up to Phase II, proof of concept efficacy in human. We identify innovative therapeutic drug candidates globally, and develop these drug candidates in accordance to the United States Food and Drug Administration (the "FDA") regulatory standards to feed the product development pipelines of the pharmaceuticals industry. We currently have two product pipelines in our technology portfolio: PAC-113, an anti-fungal for the treatment of oral Candidiasis, and PAC-G31P, a novel peptide therapeutic designed to treat inflammatory diseases characterized by non-beneficial neutrophil.

PAC-113 is a 12 amino-acid antimicrobial peptide derived from a naturally occurring histatin protein found in saliva. This peptide alters the permeability of fungal cell membranes causing cell death. We are developing PAC-113 in a mouthrinse formulation for the topical treatment of oral Candidiasis. Oral Candidiasis, or thrush, is usually seen as a secondary consequence arising from one of a number of primary or underlying medical conditions including HIV/AIDS, cancer, diabetes, asthma and xerostomia (abnormal dryness of the mouth). We obtained our rights to PAC-113 through a sublicense agreement with Demegen, Inc. (the "Demegen Sublicense") in February 2005. The Demegen Sublicense provides us with exclusive worldwide rights to develop and commercialize PAC-113 for human oral disease conditions. Since obtaining these rights, we have completed formulation optimization work, a Phase I/II proof of concept clinical study, as well as a Phase IIb dose-ranging study. The data from our clinical studies demonstrates that PAC-113 is effective in the treatment of oral Candidiasis. The data also suggests that PAC-113 compares favourably to the efficacy demonstrated by Nystatin, a current standard of care. We are currently seeking for a collaborative partner to advance PAC-113 into pivotal Phase II/III clinical development.

PAC-G31P is a small recombinant protein that is a synthetic analogue of the human cytokine called Interleukin-8 which is the key chemokine involved in neutrophil recruitment. We are developing PAC-G31P to treat inflammatory diseases. Non-beneficial neutrophil recruitment is a key characteristic of a number of acute and chronic inflammatory conditions, including acute respiratory distress syndrome, severe asthma, chronic obstructive pulmonary disease, pneumonia, Crohn's Disease, rheumatoid arthritis and ischemia/reperfusion injury. We obtained exclusive worldwide rights to PAC-G31P technology for the prevention and treatment of severe inflammatory diseases characterized by neutrophil over-recruitment in April 2006, through the acquisition of IL Therapeutics Inc. ("ILT"). Since taking over the PAC-G31P program, we conducted a number of preclinical and mechanistic studies,

and initiated formulation development work. PAC-G31P is currently in preclinical development. We are currently seeking for a joint-venture / co-development partner to conduct preclinical and toxicology studies, as well as manufacturing work necessary to enable a filing of Investigational New Drug application (“IND”) with the FDA.

We currently hold the rights to 29 patents and 32 patent applications in the United States and other jurisdictions relating to products in our development pipeline. We also hold 2 granted patents and 8 patent applications and intellectual properties to two other research compounds that we no longer develop.

## **CORPORATE DEVELOPMENT SINCE LAST FISCAL YEAR**

On June 5, 2008, we released positive topline results from our Phase IIb dose-ranging trial of PAC-113. The results demonstrated that PAC-113 is effective in the treatment of oral Candidiasis and compares favourably to the efficacy demonstrated by Nystatin.

On October 24, 2008, we entered into a letter of intent for a business combination with Medigen Biotechnology Corp. (“Medigen”), a biotech company in Taiwan. In connection with the transaction, we would acquire all of the issued and outstanding shares of Medigen by way of share purchase or through such other transaction structure as may be determined by the mutual agreement of Pacgen and Medigen. In connection with the proposed transaction, Mr. Duffy DuFresne departed Pacgen as our President, CEO and director to pursue other interests.

On October 31, 2008, we appointed Mr. Chung Yu Wang, Chairman and director, as our interim President and Chief Executive Officer and Mr. Kevin McGarry, director, as lead independent director of the Board. These appointments followed the departure of Mr. Duffy DuFresne as President and Chief Executive Officer and director to pursue other interests.

On December 29, 2008, we announced that we have terminated our letter of intent for a business combination with Medigen. In accordance with the letter of intent signed in October 2008, the closing of the proposed business combination was subject to certain terms and conditions, including obtaining necessary approvals to enter into a definitive agreement. The parties determined that, in a share for share exchange transaction, the regulatory requirements in Taiwan would require an issuer to redeem dissenting shareholder interests for cash. Both parties anticipated that this requirement would negatively affect the liquidity and capital resources of the combined company, and that the proposed merger would be a significant undertaking given current financial market conditions. As a result, both parties have mutually elected not to proceed with the signing of a definitive agreement.

On January 30, 2009, we announced that we intended to offer, through one or more tranches of closings of a non-brokered private placement, convertible debentures in an aggregate principal amount of up to approximately \$610,000 (the “Offering”). We closed this Offering in two tranches in February 2009 and March 2009 for an aggregate principal amount of \$614,500.

On March 6, 2009, we finalized our negotiation with a vendor to settle our outstanding account of approximately US\$1.3 million (\$1.65 million). We received a credit note and recovered approximately US\$604,000 (\$747,000) of research and development expenditures from this vendor. For the remaining balance of US\$708,000 (\$893,000), we made an initial payment of US\$128,000 (\$157,000) and agreed to pay the balance of US\$580,000 (\$731,000) by installments. We have been in constant communication with this vendor to keep them apprised of the Company’s developments.

On June 8, 2009, we signed a share purchase agreement with the shareholders of Xphase Pharmaceuticals Inc. (“Xphase”) as part of our efforts to leverage our technology portfolio and enhance our ability to raise capital in the recent global financial market downturn. Xphase, a privately held pharmaceutical company, has the right to acquire the exclusive global rights, excluding China, of AF-05, a novel anti-anxiety drug candidate currently in Phase I clinical trial in China. Xphase also provides consulting and project management services to assist small to medium pharmaceutical and biotechnology companies globally. We obtained regulatory approval to complete the acquisition of Xphase in July 2009. Following the acquisition of Xphase, we have positioned ourselves to become a global life science technology transfer company focused on the commercial development of novel therapeutic drug candidates up to Phase II human proof of concept.

## RESEARCH AND DEVELOPMENT UPDATE

### *PAC-113*

During the fiscal year ended March 31, 2009, our development efforts were focused primarily on completing the Phase IIb dose-ranging trial initiated in the preceding fiscal year. In June 2008, we completed and announced results from this clinical trial. The results demonstrated that PAC-113 was effective in the treatment of oral Candidiasis and compared favourably to the efficacy demonstrated by Nystatin, a current standard of care.

The Phase IIb dose-ranging trial involved 223 seropositive HIV patients with oral Candidiasis, and was conducted at sites in the United States and South Africa. The objectives of the trial were to identify an optimal dose of PAC-113 from among the three doses studied, and to determine the relative efficacy of this PAC-113 dose as compared to Nystatin in eliminating clinical signs and symptoms of oral Candidiasis. Additionally, safety and tolerance and the microbiological response of *Candida albicans* to treatment were also measured.

The optimal dose of PAC-113 demonstrated a 34% increase in the primary endpoint efficacy level (complete clinical cure rate at Day 19) for the Per Protocol analysis as compared to Nystatin, and a 50% increase in the corresponding Intent to Treat analysis. Secondary efficacy endpoints showed similar trends among the three PAC-113 doses and the Nystatin group. Results also confirmed that PAC-113 was generally safe and well-tolerated.

The next development milestone is to meet with the FDA to discuss pivotal Phase II/III development plan. We are currently seeking for a partner to collaborate with us to advance PAC-113 into final stage of clinical development and to commercialize the product.

### *PAC-G31P*

During the fiscal year ended March 31, 2009, we conducted certain preclinical studies primarily through our collaboration with the University of Saskatchewan, St. Michael's Hospital and the University of Iowa. The results from these studies provided additional preclinical data to confirm the mechanism of action of PAC-G31P and the potential use of PAC-G31P in different animal models. Due to financial constraints, no large scale study was conducted on PAC-G31P during the fiscal year ended March 31, 2009.

The next development milestone is to conduct necessary studies to enable an IND filing with the FDA. We expect these studies to include preclinical safety and toxicology studies at Good Laboratory Standards ("GLP") level, as well as manufacturing and formulation work at Good Manufacturing Practice Standards ("GMP") level. We are currently seeking for a partner to co-develop PAC-G31P.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table sets forth consolidated financial data for the fiscal years ended March 31, 2009, 2008 and 2007:

	For the year ended March 31,		
	2009	2008	2007
Net loss for the period	\$(2,282,640)	\$(5,974,712)	\$(4,353,837)
Per share loss, basic and fully diluted	\$(0.06)	\$(0.19)	\$(0.20)
Total assets	\$1,676,523	\$3,024,237	\$7,834,666
Long-term liabilities	\$216,459	—	—

## RESULTS OF OPERATIONS

For the year ended March 31, 2009 ("Fiscal 2009"), we recorded a net loss of \$2,282,640 (\$0.06 per common share), compared to a net loss of \$5,974,712 (\$0.19 per common share) for the year ended March 31, 2008 ("Fiscal 2008"). The decrease of \$3,777,072 in net loss in Fiscal 2009, as compared to Fiscal 2008, was largely due to a reduction in our operating expenses following our cost control programs and a recovery of research and development expenditures.

The recent global financial market downturn has led to an overall tightening in the credit markets and a substantial reduction in capital available to companies in the development stage. This financial market condition has significantly affected smaller life science technology companies which are generally viewed as higher risk investments. We undertook a comprehensive review of our product development programs, operations and projected cash requirements with the view of conserving cost and deferring cash outflows. During the fiscal year ended March 31, 2009, we implemented further cost reduction programs in addition to those implemented in the preceding fiscal year. We also ceased research and development activities and focused our operations in business development to secure collaborative partners for our technology pipelines and undertook a number of financing initiatives including a small bridge financing and negotiation with our major vendors for defer payments .

Starting in November 2007 in the preceding fiscal year, we eliminated two administrative positions, reduced management salaries by 30% and focused our development efforts primarily on our lead program, PAC-113. A further reduction in management salaries was implemented in February 2008. Following the completion of our Phase IIIb clinical trial of PAC-113 in June 2008, we further reduced our research and development activities and focused our operational activities in financing and business development.

During the quarter ended March 31, 2009, we closed our convertible debenture financing for an aggregate proceed of \$614,500. We also finalized our negotiation with a vendor to settle our outstanding account of approximately US\$1.3 million (\$1.65 million). As part of our negotiation, we received a credit note and recovered approximately US\$604,000 (\$747,000) of research and development expenditures from this vendor and made arrangement to settle the remaining balance of US\$708,000 (\$893,000). Of this amount, we made an initial payment of US\$128,000 (\$157,000) in February 2009 and agreed to pay the balance of US\$580,000 (\$731,000) by installments.

Since we commenced operations in April 2004, we have not generated any revenue from our operations and have accumulated a deficit of \$14,830,321 as at March 31, 2009.. Therefore, we are considered to be in the development stage. As at March 31, 2009, we had \$308,871 of cash and cash equivalents and a working capital deficiency of \$1,023,213. We believe the remaining cash on hand will finance our operations into second half of calendar year 2009. However, given our working capital deficiency as at March 31, 2009, we may be unable to continue to realize our assets and discharge our obligations in the normal course, which cast substantial doubt about our ability to continue as a going concern.

We are currently seeking additional funding to finance our operations and obligations. Management is considering all possible financing alternatives, including equity financing, debt financing, joint-venture, corporate collaboration and licensing arrangement, and has initiated preliminary discussions on some of these alternatives. While we have been successful in securing financings in the past, there can be no assurance that such financing will be materialized or be completed on a timely basis and on favorable terms. If we are unable to obtain additional financing or complete a collaborative transaction, we may have to further scale back our operations, consider business combinations or shut down some or all of our operations.

Our financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that we will be able to meet its obligations and continue our operations for the next fiscal year. Realization values may be substantially different from the carrying values as shown and these financial statements which do not give effect to adjustments that would be necessary to the carrying values and classifications of assets and liabilities should we unable to continue as a going concern. If the going concern assumption was not used, adjustments required to report our assets and liabilities, as well as to report on our net loss, on a liquidation basis could be material.

## Revenues

We have not generated any revenue from sales of commercial products since our incorporation and we do not expect to generate any revenue until we secure collaborative partners who provide funding on our research and clinical development or upon sales of our product candidates.

## Research and Development Expenditures

Research and development expenses for Fiscal 2009 were \$1,451,884 which was further reduced by a recovery from a credit note of a vendor of \$747,214 (approximately US\$604,000) and an underlying accretion of interest of \$118,073 resulting in net expenditures of \$586,597, compared to \$3,480,523 for Fiscal 2008. The decrease in research and development expenditures was primarily due to our reduced development activities for all projects following our comprehensive review. We also eliminated two full-time positions and replaced these positions with one consultant position.

The following provides a summary of the research and development expenditures by programs for the two most recent fiscal years and since inception:

Project	For the year ended March 31, 2009	2008	Cumulative from Inception to March 31, 2009
PAC-113 (2005 – 2009)			
Expense	\$1,154,902	\$2,302,548	\$5,469,146
Recovery	(865,287)	—	(865,287)
	289,615	2,302,548	4,603,859
PAC-G31P (2007 – 2009)	272,306	1,146,834	2,099,603
Other Projects	24,676	31,141	213,565
	\$586,597	\$3,480,523	\$6,917,027

### PAC-113

Development expenses for this program decreased by \$1,147,646 in Fiscal 2009 as compared to those in Fiscal 2008. In addition, we recovered \$747,214 associated with the Phase IIB clinical trial as part of our settlement with a vendor. Inclusive of this expense recovery and an underlying accretion of interest of \$118,073, development expenditures incurred for PAC-113 declined by \$2,012,933. The reduced development expenditures was mainly due to the decision, following our comprehensive review, to defer further development of PAC-113 until a collaborative partner is secured. We completed our Phase IIB clinical study in June 2008 and obtained favorable results from this clinical study. Using these results and data accumulated to date, we are seeking for a partner to collaborate with us to advance PAC-113 into final stage of clinical development and to commercialize the product.

The development expenditures in Fiscal 2009 covered primarily the costs associated with wrapping up our Phase IIB study. The development expenditures in Fiscal 2008 included the costs associated with the initiation of the Phase IIB study as well as those linked to the completion of the Phase I/II study. The external cost for the Phase IIB study, which involved 223 patients, was approximately \$2.5 million and was incurred over two fiscal years ended March 31, 2009. The Phase IIB study was initiated in November 2007 and completed in June 2008. The external cost for the Phase I/II study, which involved 107 patients, was approximately \$1.6 million and was spread over three fiscal years ended March 31, 2008. The Phase I/II trial was initiated in March 2006 and completed in May 2007.

For the fiscal year ending March 31, 2010 (“Fiscal 2010”), we expect to incur minimal research and development expenditures for PAC-113 until a collaborative partner is secured. The expected research and development cost is those related stability studies and license maintenance.

### *PAC-G31P*

Research expenditures for PAC-G31P decreased by \$874,528 in Fiscal 2009, as compared to those in Fiscal 2008. As discussed earlier, following the initiation of our cost control program in November 2007, we devoted our research and development efforts primarily on our other program, PAC-113.

Research expenditures in Fiscal 2009 covered primarily the costs related to preclinical studies conducted through our collaborations with the University of Saskatchewan, St. Michael's Hospital and the University of Iowa. Research expenditures in Fiscal 2008 covered primarily the costs associated with preclinical studies conducted through various commercial research organizations, as well as manufacturing and formulation development work.

For Fiscal 2010, we expect to incur minimal research and development expenditures for PAC-G31P until a joint-venture / co-development partner is secured. The expected research and development cost is those related license maintenance.

### ***General and Administration Expenditures***

General and administration expenditures for Fiscal 2009 were \$1,052,414, compared to \$1,901,567 for Fiscal 2008. The decrease of \$849,153 was primarily attributable to the implementation of our cost control programs. The following provides a summary of the general and administration expenditures for the two most recent fiscal years and since inception:

General and Administration Expenditures	For the year ended March 31,		Cumulative from
	2009	2008	Inception to March 31, 2009
Salaries and benefits	\$307,808	\$811,353	\$2,440,714
Consulting and professional fees	466,382	539,543	1,823,279
Travel and accommodation	48,202	87,530	337,408
Market research for product candidate	—	125,981	136,149
Other general overhead	230,022	337,160	1,341,832
	<u>\$1,052,414</u>	<u>\$1,901,567</u>	<u>\$6,079,382</u>

In comparative to the same line item in Fiscal 2008:

- Salaries and benefits declined by \$503,545 in Fiscal 2009 as a result of our reduced workforce and management salaries. During Fiscal 2009, we eliminated five full-time positions and replaced these positions with two consultant positions. In addition, on October 31, 2008, we appointed Chairman of our board of directors, Mr. Chung-Yu Wang, to act as our interim President and Chief Executive Officer to oversee our operations. No salary or management fee was paid to Mr. Wang.
- Consulting and professional fees declined by \$73,161 in Fiscal 2009, primarily due to an elimination of all director fees effective February 2008. These cost savings were offset by an increase in professional fees associated with various business development activities including the previously proposed merger with Medigen.
- No market research expenditure was incurred in Fiscal 2009 given the completion of PAC-113 market research in the preceding year.
- The reduced travel and accommodation expenses, as well as reduced general overhead in Fiscal 2009 were due to our cost control programs including sub-letting part of our office facilities.

For Fiscal 2010, we expect our general and administration expenditures to be lower than those incurred in Fiscal 2009. As part of our proposed Xphase acquisition, in addition to 100% equity interest of Xphase, we would receive management and business development services from Xphase principals.

### ***Stock-based Compensation***

Stock-based compensation, a non-cash item included in operating expenses, reduced to \$160,687 in Fiscal 2009, compared to \$346,348 in Fiscal 2008. Stock-based compensation attributable to research and development operations and general administration for Fiscal 2009 was \$62,391 [2008 - \$131,702] and \$98,296 [2008 - \$214,646], respectively. The decrease in stock-based compensation was primarily due to the increased number of options forfeited or cancelled, as well as the reduced number of stock options granted during Fiscal 2009 as compared to Fiscal 2008.

### ***Amortization***

Amortization was \$263,816 in Fiscal 2009, compared to \$269,245 in Fiscal 2008. Amortization related to technology, licenses and rights was \$236,974 in Fiscal 2009, compared to \$236,975 in Fiscal 2008. The remaining amortization was related to property and equipment.

### ***Other Loss***

Other loss in Fiscal 2009 was \$219,126, compared to \$62,029 in Fiscal 2008. The increase of \$157,097 in other loss was mainly due to a decline in interest income by \$55,715 and an increase of foreign exchange loss by \$103,951 in Fiscal 2009, as compared to those in Fiscal 2008. The decrease in interest income was due to lower interest rates and lower cash balances. The increase in net foreign exchange loss was primarily due to the appreciation of the United States dollar, in comparison with the Canadian dollar, on our US denominated retainer payments, accounts payable and accrued liabilities. We are exposed to market risk related to currency exchange rates in the United States because the majority of our clinical development and manufacturing development expenditures are incurred in United States dollars.

## **SUMMARY OF QUARTERLY RESULTS**

Set forth below is the selected consolidated financial data for each of the last eight quarters:

	4th Quarter Ended March 31, 2009 ("Q4 2009")	3rd Quarter Ended December 31, 2008 ("Q3 2009")	2nd Quarter Ended September 30, 2008 ("Q2 2009")	1st Quarter Ended June 30, 2008 ("Q1 2009")
Research and development	\$(87,804)	\$537,658	\$(155,264)	\$(881,187)
General and administration	(171,039)	(277,673)	(298,815)	(304,887)
Stock based compensation	40,879	(51,410)	(91,346)	(58,810)
Amortization	(64,895)	(66,307)	(66,307)	(66,307)
Other income (loss)	(28,128)	(163,966)	(30,722)	3,690
Future income tax recovery	—	—	—	—
Net loss for the period	(310,987)	(21,698)	(642,454)	(1,307,501)
Basic and diluted loss per common share	\$(0.01)	\$(0.00)	\$(0.02)	\$(0.04)

	4th Quarter Ended March 31, 2008 ("Q4 2008")	3rd Quarter Ended December 31, 2007 ("Q3 2008")	2nd Quarter Ended September 30, 2007 ("Q2 2008")	1st Quarter Ended June 30, 2007 ("Q1 2008")
Research and development	\$(1,071,903)	\$(431,197)	\$(912,203)	\$(1,065,220)
General and administration	(307,439)	(406,920)	(550,878)	(636,330)
Stock based compensation	(119,597)	(68,928)	(71,418)	(86,405)

Amortization	(63,905)	(68,661)	(68,569)	(68,110)
Other income (loss)	(129,095)	(7,358)	28,015	46,409
Future income tax recovery	27,722	12,079	30,199	15,000
Net loss for the period	(1,664,217)	(970,985)	(1,544,854)	(1,794,656)
Basic and diluted loss per common share	\$(0.05)	\$(0.03)	\$(0.05)	\$(0.06)

### *Summary of Quarterly Results*

The primary factors affecting the magnitude of our losses in the various quarters were (i) expenditures associated with our PAC-113 Phase I/II and Phase IIb clinical trials (ii) recovery of part of our Phase IIb clinical expenditures and an underlying accretion of interest, and (iii) the implementation of our cost programs in different stages.

Research and development expenditures were in a declining trend throughout Fiscal 2009 as a result of (i) our decision in November 2007 to focus our development efforts primarily on the completion of PAC-113 Phase IIb clinical study and to scale down of PAC-G31P research and development activities (ii) further reduction in research and development activities following the completion of the Phase IIb study in June 2008, and (iii) a recovery of \$747,214 (approximately US\$604,000) of expenditure associated with PAC-113 Phase IIb in the second half of 2009 and an underlying accretion of interest of \$118,073. General and administration expenditures were also in a declining trend as a result of our cost control programs. The cost control programs in Fiscal 2009 involved (i) elimination of five full-time positions with a replacement of two consultant positions (ii) appointment of Chairman of our board of directors to act as our interim President and Chief Executive Officer, and (iii) elimination of all director fees effective February 2008.

Research and development expenditures were relatively the same throughout the Fiscal 2008 except in Q3 2008. The decline in research and development expenditures in Q3 2008 was primarily due to (i) the reduced development activities for PAC-113 as we prepared to advance this project into Phase IIb and (ii) the completion of PAC-G31P GLP manufacturing development. The significant timelines impacting our research and development cost in Fiscal 2008 were: the completion of PAC-113 Phase I/II clinical trial in May 2007, the completion of PAC-G31P manufacturing development at GLP level in July 2007, and the initiation of PAC-113 Phase IIb trial in November 2007. General and administration expenditures were in a declining trend throughout Fiscal 2008. This was primarily due to (i) one-time expenditures associated with PAC-113 market research in Q1 2008, and (ii) the initiation of our cost control programs in November 2007.

### **FOURTH QUARTER RESULTS**

Net loss for Q4 2009 was \$310,987 (\$0.01 per share), compared to net loss of \$1,664,217 (\$0.05 per share) for Q4 2008. The decrease of \$1,353,230 in net loss was primarily due to a decline of \$1,279,985 in operating expenditures and a decline of \$100,967 in other loss; these were offset by a decline of \$27,722 in future income tax recovery.

Research and development costs for Q4 2009 were \$87,804, compared to \$1,071,903 for Q4 2008. The decrease of \$984,099 was primarily due to the reduced research and development activities following the completion of PAC-113 Phase IIb study and an underlying accretion of interest. As mentioned earlier, as part of our cost control programs, further development on PAC-113 and PAC-G31P would be initiated once collaborative partners or joint-venture partners are secured.

General and administration expenses for Q4 2009 were \$171,039, compared to \$307,439 for Q4 2008. The decrease of \$136,400 was primarily attributable to the implementation of our cost control programs. As compared to the same quarter in the preceding year, we incurred lower salaries and benefits as a result of the reduced internal workforce and the appointment of Chairman of our board as interim CEO arrangement. We also incurred lower professional fees. These cost savings were offset by higher travel and accommodation expenses associated with various business development activities, as well as general overhead.

## LIQUIDITY AND CAPITAL RESOURCES

### *Sources and Uses of Cash*

Since inception to March 31, 2009, our operational activities were financed mainly from equity financings, other than the recent issuance of convertible debentures, and the cash acquired from ILT.

Cash used in operating activities for Fiscal 2009 was \$1,740,545, compared to \$4,700,919 for Fiscal 2008. Cash used in operating activities was composed of net loss, add-backs or adjustments not involving cash and net change in non-cash working capital items. The decrease of \$2,960,374 in cash used in operating activities in Fiscal 2009 as compared to Fiscal 2008 was primarily due to the decreased operating loss.

Cash used in investing activities in Fiscal 2009 was \$3,775, compared to \$4,734 of cash provided by investing activities in Fiscal 2008. The increase of cash used in investing activities was primarily due to the one-time leasehold inducement received in Fiscal 2008. Cash used in Fiscal 2009 was composed of costs associated with the Xphase acquisition. Cash provided by the disposal of property and equipment and leasehold inducement was offset by cash used in the purchases of property and equipment in Fiscal 2008.

Cash provided by financing activities in Fiscal 2009 was \$614,500, compared to \$747,510 in Fiscal 2008. Cash provided by financing activities in Fiscal 2009 was associated with our private placement financing of convertible debentures. Cash provided by financing activities in Fiscal 2008 was associated with our private placement financing of units in March 2008.

We closed a private placement of convertible debentures in two tranches in February 2009 and March 2009 for an aggregate principal amount of \$614,500. The convertible debentures will bear interest from the date of issuance at a rate of prime plus 4% per annum and will mature one year from the date of issuance. The principal amount under the convertible debentures plus any accrued interest will be repayable in cash or convertible, at the option of the holder, into units of the Company (the "Units") at a conversion price of \$0.10 per Unit. Each Unit will consist of one common share of the Company (a "Common Share") and one common share purchase warrant (a "Warrant"), each Warrant entitling a non-insider holder to purchase one Common Share at an exercise price of \$0.10 per Common Share at any time prior to 24 months following the date of issuance of the Warrant upon conversion of the convertible debenture. The Warrants comprising the Units issuable upon conversion of convertible debentures issued to insiders of the Company will expire upon the earlier of the maturity date of the convertible debentures and the date that is 24 months following the date of issuance of the Warrants upon conversion of the convertible debentures.

In connection with the private placement financing in March 2008, we 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 (a "Common Share") and one common share purchase warrant (a "Warrant"). One Warrant entitles the holder to purchase one Common Share at \$0.30 per Common Share until March 16, 2013. In connection with this private placement, we 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 comprised of one Common Share and one Warrant. 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 Warrant exercisable into one additional Common Share at \$0.30 per Common Share until March 16, 2013. The Compensation Units and Broker's Warrants have an estimated value of \$40,960.

At March 31, 2009, we had a negative working capital of \$1,023,213, compared to a working capital of \$535,149 at March 31, 2008. We had available cash reserves comprised of cash and cash equivalents of \$308,871 at March 31, 2009, compared to \$1,438,691 at March 31, 2008. We estimate that our cash reserves at March 31, 2009 is adequate to fund our operations and capital needs into the second half of calendar year 2009.

As of March 31, 2009 and in the normal course of business we have obligations to make future payments, representing contracts and other commitments that are known, committed, cancellable and non-cancellable.

	Contractual Obligations payment due by period				
	Total	2010	2011-2012	2013-2014	Thereafter
Operating Leases	\$157,363	\$101,372	\$55,991	—	—
Clinical Research Agreements <sup>(1)</sup>	2,923,950	2,923,950	—	—	—
License Agreements <sup>(2)</sup>	484,294	168,969	126,130	126,130	63,065
<b>Total</b>	<b>\$3,565,607</b>	<b>\$3,314,887</b>	<b>\$182,121</b>	<b>\$126,130</b>	<b>\$63,065</b>

<sup>(1)</sup> The total commitment of \$2,923,950 reflects \$490,966 of commitments that are non-cancellable and \$2,432,984 of commitments that are cancellable should we decide to discontinue the related clinical research work.

<sup>(2)</sup> Pursuant to the Demegen Sublicense, we have a commitment to pay minimum annual royalties of US\$50,000 described in *note 9(a)* of our annual consolidated financial statements for the fiscal year ended March 31, 2009. This commitment is converted into Canadian Dollars at the closing rate on March 31, 2009 of CAD\$1.00 = US\$0.7928. Pursuant to a license agreement between ILT and the University of Saskatchewan (the “US License”), we have a commitment to sponsor \$500,000 for research to be performed at the University of Saskatchewan, including, but not necessarily limited to, research related to the licensed technology PAC-G31P, within 5 years of the term of the agreement (\$334,097 has been paid as of March 31, 2009).

## OUTSTANDING SHARE CAPITAL

As of June 30, 2009, there were 35,144,693 common shares issued and outstanding, 4,656,933 common share purchase warrants outstanding at a weighted average exercise price of \$0.30 per common share, and 1,403,333 incentive stock options outstanding at a weighted average exercise price of \$0.99.

## OFF-BALANCE SHEET ARRANGMENTS

We have no off-balance sheet arrangements.

## RELATED PARTY TRANSACTIONS

During Fiscal 2009, we incurred \$503 [2008 - \$3,186] for consulting services provided by directors, \$nil [2008 - \$1,000] for research services provided by a consulting firm of which a director is the principal; \$nil [2008 - \$120,988] for research services provided by a consulting firm of which an officer is the principal; and \$nil [2008 - \$5,645] for research services provided by a university laboratory of which an officer is a professor.

## CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

Our audited consolidated financial statements are prepared in accordance with Canadian GAAP. These accounting principles require us to make certain estimates and assumptions. We believe that the estimates and assumptions upon which we rely are reasonable based upon information available at the time that these estimates and assumptions are made. Actual results could differ from these estimates. 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 significant accounting policies that we believe are the most critical in fully understanding and evaluating the reported financial results include those which follow:

### *Intangible Assets*

Intangible assets are comprised of 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 lives of the underlying technologies. We determine the estimated useful lives for intangible assets based on a number of factors: legal, regulatory or contractual limitations; known technological

advances; anticipated market size; and the existence or absence of competition. A significant change in any of the above factors may require a revision of the expected useful life of the intangible asset, resulting in accelerated amortization or an impairment charge, which could have a material impact on our results of operations. We evaluate the recoverability of the net book value of our intangible assets whenever events or changes in circumstances indicate the carrying value may not be recoverable. If the carrying value of the underlying technology exceeds the estimated net recoverable value, calculated based on estimated undiscounted future cash flows, then the carrying value is written down to its fair value, based on the related estimated discounted cash flows. The amounts shown for technology licenses and rights do not necessarily reflect present or future values and the ultimate amount recoverable will be dependent upon the successful development and commercialization of products based on these rights.

### ***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 GAAP 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 our behalf, are recognized in an accounting period based on estimates of the work performed during the period using an accrual basis of accounting. Since the service agreements with these vendors may be in force over a number of accounting periods and payments may not coincide with the period in which the services are rendered, judgment is required in estimating the amount of research and development expense to be recorded in each accounting period. Judgment and estimates are also involved in determining the amount of expenditures that are contractually committed under the various agreements. We consider the following factors in estimating the amount of clinical trial expense for an accounting period: the level of patient enrolment; the level of services provided and goods delivered; and the proportion of the overall contracted time that elapsed during the accounting period. In making these assessments, we monitor patient enrolment levels and related activities at a given point in time through internal reviews, correspondence and discussions with contractors and review of contractual terms. We may sometimes rely on the information provided by our contractors. A significant change in the above factors and the accuracy of information provided by our contractors may alter our estimate of our clinical trial expenditure for the accounting period and prepaid expenses or accrued liabilities as of the end of the accounting period. This could have a material impact on our results of operations and accrued liabilities.

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 estimates of the activities.

### ***Stock-based Compensation and other stock-based payments***

We grant stock options to employees, directors, and consultants pursuant to a stock option plan. We use 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. 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. We amortize the fair value of stock options over the vesting terms of the options which are generally two to three years from grant.

The estimation of the fair value of stock options using the Black-Scholes option pricing model involves subjective assumptions of the expected life of the option, the expected volatility at the time the options are granted, and the risk-free interest rate. Changes in these assumptions can materially affect the measure of the estimated fair value of our stock options, hence our results of operations.

## **CHANGE OF ACCOUNTING POLICIES**

### ***General Standards of Financial Statement Presentations***

In May 2007, the Canadian Accounting Standards Board (the “AcSB”) amended CICA Handbook Section 1400, “General Standards of Financial Statement Presentation”, to change the guidance related to management’s responsibility to assess the ability of the entity to continue as a going concern.

The main features of the changes are as follows:

- (i) management is required to make an assessment of an entity’s ability to continue as a going concern;
- (ii) in making its assessment, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date;
- (iii) financial statements must be prepared on a going concern basis unless management either intends to liquidate the entity, to cease trading or cease operations, or has no realistic alternative but to do so;
- (iv) disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern; and
- (v) when financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason the entity is not regarded as a going concern.

This section became effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. We adopted these standards commencing April 1, 2008. The new disclosure requirements pertaining to this section are contained in *note 1* of our consolidated financial statements.

### ***Capital Disclosures***

The AcSB issued Section 1535, “Capital Disclosures”. This section establishes standards for disclosing information about an entity’s capital and how it is managed in order that a user of the financial statements may evaluate the entity’s objectives, policies and processes for managing capital. This section became effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. We adopted these standards commencing April 1, 2008. The adoption of these new standards did not have a material impact on our consolidated financial statements. The new disclosure requirements pertaining to this section are contained in *note 4* of our audited annual consolidated financial statements.

### ***Financial Instruments – Disclosure and Presentation***

The AcSB issued two new sections in relation to financial instruments: Section 3862, “Financial Instruments – Disclosure” and Section 3863, “Financial Instruments – Presentation”. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new presentation standard carries forward the former presentation requirements. Both sections became effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. We adopted these standards commencing April 1, 2008. The adoption of these new standards did not have a material impact on our consolidated financial statements. The new disclosure requirements pertaining to these sections are contained in *note 5* of our audited annual consolidated financial statements.

### ***New Accounting Pronouncements***

In February 2008, the AcSB confirmed that Canadian GAAP for public companies will be converged with International Financial Reporting Standards (“IFRS”) for accounting periods commencing on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are some significant differences on recognition, measurement and disclosures. We will be required to report under IFRS for interim and annual financial statements beginning April 1, 2011 and provide IFRS comparative figures for the preceding fiscal year, including an opening balance sheet as at April 1, 2010. We are currently planning for the conversion to IFRS and conducting a high-level preliminary assessment of the differences between Canadian GAAP and IFRS and the potential impact of IFRS to our financial reporting systems and processes.

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 our consolidated financial statements beginning April 1, 2009. We are evaluating the impact of the adoption of this new section on our consolidated financial statements and currently expect no significant impact from this adoption.

In January 2009, the CICA issued Section 1601 “*Consolidations*” and Section 1602 “*Non-controlling Interests*”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are applicable to our interim and annual financial statements beginning April 1, 2011. We are in the process of evaluating the impact of these standards.

In January 2009, the CICA issued Section 1582 “*Business Combinations*” replacing Section 1581 “*Business Combinations*”. The new section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The section is applicable to our annual and interim financial statements beginning April 1, 2011, with early adoption permitted. We are in the process of evaluating the impact of this standard.

In January 2009, the CICA issued EIC 173 “*Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*”. This guidance requires that an entity's own credit risk and the credit risk of the counterparty be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to our annual and interim financial statements beginning April 1, 2009 with retrospective application without restatement of prior periods. We are in the process of evaluating the impact of this new guidance.

## **RISKS AND UNCERTAINTIES**

Due to the inherent nature of our business, investing in our securities involves a high degree of risk and uncertainties. Such risk factors include, among others, our stage of development, lack of product revenues, additional capital requirements, risk associated with completion of clinical trials and obtaining regulatory approval, lack of collaborative partners at this time, dependence on collaborative partners to develop and commercialize our products once partners are secured, our ability to protect our intellectual property and our ability to stay competitive in a rapid changing industry environment.

We are in the early stage of development and have limited operating history. We have not generated any revenues to date from product sales, nor do we expect any product revenues for the immediate future. To achieve profitable operations, we must successfully develop our products that are currently in the research and development phase on our own or with collaborative partners. These product developments may take a number of years and involve significant risks and uncertainties. As a result, we require substantial additional capital to finance our product developments.

We are currently seeking additional capital to finance our operations. Management is considering all financing alternatives, including equity financing, debt arrangement, merger and acquisition, corporate collaboration and licensing arrangement, and has engaged in discussions with multiple parties on some of these alternatives. There can be no assurance that such financing will materialize on a timely basis or obtained on favorable terms. If we are unable to obtain additional financing, we may be required to curtail or discontinue our operations.

We are exposed to credit risk, interest rate risk, currency risk and liquidity risk as described in *note 5* in our audited consolidated financial statements. We are also subject to other significant risks and uncertainties listed in the section entitled “Risk Factors” in our Annual Information Form dated July 31, 2008.