

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

*This management discussion and analysis ("MD&A") was performed by management using information available as of August 21, 2009 and should be read in conjunction with our unaudited interim consolidated financial statements and notes thereto for the three months ended June 30, 2009, as well as audited consolidated financial statements and notes thereto and the MD&A for the year ended March 31, 2009. All financial information has been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), and all amounts are expressed in Canadian dollars unless otherwise indicated. Additional information relating to Pacgen Biopharmaceuticals Corporation (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 note 5 in our unaudited interim consolidated financial statements and in the "Risk Factors" section of our Annual Information Form dated July 31, 2008, 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, our ability to protect our intellectual property, and our ability to stay competitive in a rapid changing industry environment. We undertake no obligation to revise or update forward looking statements 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 DURING THE QUARTER**

During the quarter ended June 30, 2009 (“Q1 2010”), 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 to 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.

Pursuant to the share purchase agreement among the Company, Xphase and Xphase shareholders, we agreed to issue 3 million of our common shares to Xphase shareholders in exchange for 100% ownership of Xphase as well as management services of Xphase principals (the “Xphase Acquisition”). 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.

We subsequently completed the Xphase Acquisition and issued 3 million of our common shares to Xphase shareholders on August 11, 2009. Following the Xphase Acquisition, 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. We also announced the appointments of Xphase principals to our senior management team. Dr. Yiu Chung Lee, Dr. Beverly Inledon, Mr. Joel Cheng, and Mr. Gabriel Lam have been appointed as our Chief Executive Officer, Vice President, Research and Development, Vice President, Business Development, and Senior Director, Greater China Operations, respectively.

Dr. Lee is an experienced entrepreneur with more than 20 years of pharmaceutical development experience earned in various settings, including pharmaceutical company, biotechnology company as well as contract research organization. Prior to co-founding Xphase, Dr. Lee previously held positions in Eli Lilly Canada Inc., Patheon Inc. and PharmEng Technology Inc.

Dr. Inledon has more than 14 years of pharmaceutical industry experiences and extensive knowledge in drug development and manufacturing operations. Prior to joining Xphase, Dr. Inledon served as Director, Research and Development at Eli Lilly Canada Inc. Dr. Inledon also previously held positions in Glaxo Wellcome Inc. (Canada) and Syntex Inc.

Mr. Cheng has over 26 years of broad experience in sales, marketing, business development and corporate management in the North America. Prior to co-founding Xphase, Mr. Cheng served as Senior Director at PharmEng International Inc. Mr. Cheng previously held positions in MDS SCIEX and Hewlett Packard/Agilent Technologies.

Mr. Lam has extensive business operations and co-founded Xphase with Dr. Lee and Mr. Cheng. Prior to co-founding Xphase, Mr. Lam was Senior Director at PharmEng International Inc. Mr. Lam previously held various managerial positions in Rootlink Technic Inc. and Hewlett Packard/Agilent Technologies.

## RESEARCH AND DEVELOPMENT UPDATE

### *PAC-113*

During Q1 2010, other than the continuation of certain stability studies of PAC-113, we did not initiate any new research and development studies. Following a comprehensive review in the preceding fiscal year (the “Fiscal 2009”), we elected to defer further development of PAC-113 until a collaborative partner is secured. During Q1 2010, we initiated a number of discussions with potential collaborative or joint-venture partners. We continue to follow up and maintain active dialogues with some of these collaborative or joint-venture partners we identified. Despite these efforts, there can be no assurance that a collaborative partnership or joint-venture will be closed on a timely basis or with favourable terms.

The next development milestone for PAC-113 is to meet with the FDA to discuss pivotal Phase II/III development plan. Based on our Phase IIb clinical trial results obtained in June 2008, PAC-113 is effective in the treatment of oral Candidiasis and compares favorably to efficacy demonstrated by Nystatin. Nystatin is a current standard of care for topical treatment of oral Candidiasis.

### *PAC-G31P*

During Q1 2010, we did not initiate any new research and development studies for PAC-G31P due to financial constraints. Our operational efforts were focused primarily on seeking for a joint-venture partner. We continue to follow up and maintain active dialogues with a few potential collaborative or joint-venture partners we identified. Despite these efforts, there can be no assurance that a collaborative partnership or joint-venture will be closed on a timely basis or with favourable terms. The following development milestones for PAC-G31P are to determine the optimal first clinical indication and to file an IND application with the FDA.

## 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

### *Overall Performance*

For Q1 2010, we recorded a net loss of \$209,003 (\$0.01 per common share), compared to a net loss of \$1,307,501 (\$0.04 per common share) for the three months ended June 30, 2008 (“Q1 2009”). The decrease of \$1,098,498 in net loss in Q1 2010, as compared to Q1 2009, was due to a reduction in operating expenditures following the implementation of our cost control programs.

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. Following a comprehensive review in the preceding fiscal year, we implemented cost reduction programs, ceased research and development activities and focused our operations in business development to secure collaborative partners for our technology pipelines. We also undertook a number of financing initiatives including a small bridge financing and negotiation with our major vendors for defer payments.

Since we commenced operations in April 2004, we have accumulated a deficit of \$15,039,324 as at June 30, 2009. We have not generated any revenue from sales of commercial products to date and do not expect to generate any revenues until we secure a collaborative partnership or upon sales of our product candidates. Therefore, we are considered to be in the development stage.

As at June 30, 2009, we had \$108,881 of cash and cash equivalents and a working capital deficiency of \$1,450,333. We believe the remaining cash on hand will finance our operations into the second half of calendar year 2009. However, given our working capital deficiency as at June 30, 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 capital to finance our operations. Management is considering all possible financing alternatives, including equity financing, debt arrangement, joint-venture, corporate collaboration and licensing arrangement, and has initiated preliminary discussions with multiple parties 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 all of our operations.

Our financial statements have been prepared in accordance with Canadian GAAP applicable to a going concern, which assumes that we will be able to meet our 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 be 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 revenues 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 were \$36,706 for Q1 2010, compared to \$881,187 for Q1 2009. The decrease of \$844,481 was primarily due to our reduced development activities following our comprehensive review in Fiscal 2009. The following provides a summary of the research and development expenditures by programs for two comparative quarters and since inception:

Project	For the three months ended		Cumulative from
	2009	June 30, 2008	Inception to June 30, 2009
PAC-113 (2005 – 2009)			
Expense	\$26,416	\$840,150	\$5,495,562
Recovery	—	—	(865,287)
	26,416	840,150	4,630,275
PAC-G31P (2007 – 2009)	10,290	34,443	2,109,893
Other Projects	—	6,594	213,565
	\$36,706	\$881,187	\$6,953,733

### ***PAC-113***

PAC-113 development cost decreased by \$813,734 in Q1 2010 as compared to those in Q1 2009. The reduced development expenditure was mainly due to our decision to defer further development of PAC-113 until a

collaborative partner is secured. The development expenditure in Q1 2010 covered primarily the maintenance of license and patents, and those in Q1 2009 covered primarily the costs associated with our Phase IIb study.

For the remaining quarters in the current 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 license maintenance as well as stability studies.

#### *PAC-G31P*

PAC-G31P research cost decreased by \$24,153 in Q1 2010 as compared to those in Q1 2009. Research expenditure in Q1 2010 covered primarily the maintenance of patents, while those in Q1 2009 covered primarily the internal overhead associated with our research personnel.

For the remaining quarters in Fiscal 2010, we expect to incur minimal research and development expenditures for PAC-G31P until a joint-venture or collaborative partner is secured. The expected research and development cost is those related license and patents maintenance.

#### *General and Administration Expenditures*

General and administration expenses were \$54,481 for Q1 2010, compared to \$304,887 for Q1 2009. The decrease of \$250,406 was primarily attributable to the implementation of our cost control programs. The following provides a summary of the general and administration expenditures for two comparative quarters and since inception:

General and Administration Expenditures	For the three months ended		Cumulative from
	2009	2008	Inception to June 30, 2009
Salaries and benefits	\$450	\$105,705	\$2,441,164
Consulting and professional fees	7,921	141,721	1,831,200
Travel and accommodation	2,578	11,756	339,986
Market research for product candidate	—	—	136,149
Other general overhead	43,532	45,705	1,332,782
	<u>\$54,481</u>	<u>\$304,887</u>	<u>\$6,081,281</u>

Salaries and benefits declined by \$105,255 as a result of our reduced workforce and management salaries. All full-time positions have been replaced with consultant positions which primarily compensated by stock based compensation. The reduced consulting and professional fees, travel and accommodation expenses, as well as other general overhead expenses in Q1 2010 were due to our cost control programs including sub-letting part of our office facilities.

For the remaining quarters in Fiscal 2010, we expect our general and administration expenditures to be relatively the same as those incurred in Q1 2010. In accordance to the terms of the Xphase Acquisition, Xphase principals will provide management and business development services for equity based compensation.

#### *Stock-based Compensation*

Stock-based compensation, a non-cash item included in operating expenses, was \$30,695 in Q1 2010, compared to \$58,810 in Q1 2009. Stock-based compensation attributable to research and development operations and general administration for Q1 2010 was \$12,315 [Q1 2009 - \$12,693] and \$18,380 [Q1 2009 - \$46,117], respectively. The decreases 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 and vested during Q1 2010 as compared to Q1 2009.

For the remaining quarters in Fiscal 2010, we expect our stock based compensation will increase as we recognized the stock based compensation associated with management and business development services provided by Xphase principals, as part of our terms of the Xphase Acquisition.

### *Amortization*

Amortization was \$63,186 in Q1 2010, compared to \$66,307 in Q1 2009. Amortization related to technology, licenses and rights in Q1 2010 remained the same at \$59,244, compared to Q1 2009. The remaining amortization was related to property and equipment.

### *Other Income (Loss)*

Other loss in Q1 2010 was \$23,935, compared to other income of \$3,690 in Q1 2009. The increase in other loss of \$27,625 was mainly due to an increase in financing and interest expenses and a reduction in interest income. These were offset by an increase in foreign exchange gain. The financing and interest expenses of \$70,016 in Q1 2010 was associated with an amount payable to a vendor and the convertible debentures issued in Fiscal 2009. The reduced interest income was due to lower cash balances and lower interest rates. The net foreign exchange gain of \$49,357 in Q1 2010, compared to a net foreign exchange loss of \$9,281 in Q1 2009, was a result of the depreciation of the United States dollar, in comparison with the Canadian dollar, on our US denominated retainer payments, accounts payable and accrued liabilities, and other payable..

## SUMMARY OF QUARTERLY RESULTS

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

	1st Quarter Ended June 30, 2009 ("Q1 2010")	4th Quarter Ended March 31, 2009 ("Q4 2009")	3rd Quarter Ended December 31, 2008 ("Q3 2009")	2nd Quarter Ended September 30, 2008 ("Q2 2009")
Research and development	\$(36,706)	\$(87,804)	\$537,658	\$(155,264)
General and administration	(54,481)	(118,457)	(277,673)	(298,815)
Stock based compensation	(30,695)	40,879	(51,410)	(91,346)
Amortization	(63,186)	(64,895)	(66,307)	(66,307)
Other income (loss)	(23,935)	(80,710)	(163,966)	(30,722)
Future income tax recovery	—	—	—	—
Net loss for the period	(209,003)	(310,987)	(21,698)	(642,454)
Basic and diluted loss per common share	\$(0.01)	\$(0.01)	\$(0.00)	\$(0.02)

	1st Quarter Ended June 30, 2008 ("Q1 2009")	4th Quarter Ended March 31, 2008 ("Q4 2008")	3rd Quarter Ended December 31, 2007 ("Q3 2008")	2nd Quarter Ended September 30, 2007 ("Q2 2008")
Research and development	\$(881,187)	\$(1,071,903)	\$(431,197)	\$(912,203)
General and administration	(304,887)	(307,439)	(406,920)	(550,878)
Stock based compensation	(58,810)	(119,597)	(68,928)	(71,418)
Amortization	(66,307)	(63,905)	(68,661)	(68,569)
Other income (loss)	3,690	(129,095)	(7,358)	28,015
Future income tax recovery	—	27,722	12,079	30,199
Net loss for the period	(1,307,501)	(1,664,217)	(970,985)	(1,544,854)
Basic and diluted loss per common share	\$(0.04)	\$(0.05)	\$(0.03)	\$(0.05)

### ***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 IIb clinical trial (ii) recovery of part of our Phase IIb clinical expenditures and (iii) the implementation of our cost programs in different stages in the preceding two fiscal years.

Research and development expenditures were significantly reduced since Q1 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 and (ii) further reduction in research and development activities following the completion of the Phase IIb study in June 2008. The net recovery of research and development expense of \$537,658 in Q3 2009 was primarily due to a cost recovery of \$747,214 (approximately US\$604,000) associated with PAC-113 Phase IIb and an underlying accretion of interest of \$118,073, following our renegotiation with a vendor. General and administration expenditures were in a declining trend as a result of our cost control programs in the preceding two fiscal years. 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 prior to Q2 2009 were relatively higher than those in the recent quarters. These research and development expenditures were primarily related to our PAC-113 Phase II clinical trial. General and administration expenditures were in a declining trend in the four quarters ended June 30, 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 which involved elimination of two administrative positions and 30% reduction in management salaries starting November 2007. A further 20% reduction in management salaries was implemented in February 2008.

## **LIQUIDITY AND CAPITAL RESOURCES**

### ***Sources and Uses of Cash***

Since inception to June 30, 2009, our operational activities were financed mainly from equity financings, other than the recent issuance of convertible debentures in Q4 2009, and the cash acquired from ILT in April 2006.

Cash used in operating activities for Q1 2010 was \$102,722, compared to \$848,347 for Q1 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 \$745,625 in cash used in operating activities in Q1 2010 as compared to Q1 2009 was primarily due to the decreased operating loss. Cash used in investing activities in Q1 2010 was composed of costs associated with the Xphase Acquisition. There was no cash used in investing activities in Q1 2009 and cash provided by financing activities in both Q1 2010 and Q1 2009.

As of June 30, 2009, we had available cash reserves comprised of cash and cash equivalents of \$108,881, compared to \$308,871 at March 31, 2009. We had a working capital deficiency of \$1,450,333 at June 30, 2009, compared to \$1,023,213 at March 31, 2009. We are currently seeking additional capital to finance our operations and obligations. Management is considering all possible financing alternatives, including equity financing, debt arrangement, joint-venture, corporate collaboration and licensing arrangement, and has initiated preliminary discussions with multiple parties on some of these alternatives. 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 all of our operations.

As of June 30, 2008 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	\$132,020	\$76,029	\$55,991	—	—
Clinical Research Agreements <sup>(1)</sup>	2,342,219	2,342,219	—	—	—
License Agreements <sup>(2)</sup>	440,266	149,516	116,300	116,300	58,150
<b>Total</b>	<b>\$2,914,505</b>	<b>\$2,567,764</b>	<b>\$172,291</b>	<b>\$116,300</b>	<b>\$58,150</b>

<sup>(1)</sup> The total commitment of \$2,342,219 reflects \$452,604 of commitments that are non-cancellable and \$1,889,615 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 June 30, 2008 of CAD\$1.00 = US\$0.8598. The Company paid \$43,000 of the minimum royalty payment of US\$50,000 for 2008 and obtained acknowledgement from the licensor that the payment for the remaining balance of \$7,000 for 2008 and the minimum royalty payment for 2009 would be deferred. 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 June 30, 2009). The Company is committed to provide funding for the remaining balance of \$165,095 by October 15, 2009.

## OUTSTANDING SHARE CAPITAL

As of August 21, 2009, there were 38,144,693 common shares issued and outstanding, 4,656,933 common share purchase warrants outstanding at a weighted average price of \$0.30 per share, and 3,080,000 incentive stock options outstanding at a weighted average exercise price of \$0.46.

## OFF-BALANCE SHEET ARRANGMENTS

We have no off-balance sheet arrangements.

## RELATED PARTY TRANSACTIONS

There were no transactions with related parties during the quarter ended June 30, 2009.

## CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

Our unaudited interim 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 going concern assumption, intangible assets, stock-based compensation and income taxes. These and other significant accounting policies are described in *notes 1 and 2* of our annual consolidated financial statements and management discussion and analysis for the fiscal year ended March 31, 2009.

### ***Changes in Significant Accounting Policies***

Commencing April 1, 2009, we adopted recommendations of the CICA new Section 3064, “*Goodwill and Intangible Assets*”. This new section 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 adoption of these new standards did not have a material impact on our consolidated financial statements.

Commencing April 1, 2009, we also adopted guidance of the CICA 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 our financial periods ending on or after January 20, 2009 with retrospective application without restatement of prior periods. The adoption of these new standards did not have a material impact on our consolidated financial statements.

### ***New Accounting Pronouncements Affecting Future Periods***

In February 2008, the Canadian Accounting Standard Board (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 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. 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 the annual and interim financial statements of the Company beginning on or January 1, 2011, with early adoption permitted. We are in the process of evaluating the impact of this standard.

### **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, dependence on collaborative partners, 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, 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 risks, interest rate risk, currency risk and liquidity risks as described in *note 5* in our unaudited interim 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.