

## 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 November 23, 2009 and should be read in conjunction with our unaudited interim consolidated financial statements and notes thereto for the three and six months ended September 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, in the "Risks and Uncertainties" section of our annual MD&A dated July 9, 2009, and in the "Risk Factors" section of our Annual Information Form dated July 31, 2008, which are 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 September 30, 2009 (“Q2 2010”), we completed the acquisition 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.

The acquisition provides us a right to acquire the exclusive global rights, excluding China, of AF-05, as well as management services of Xphase principals at no additional compensation, other than grant of options priced at premium. We issued 3 million of our common shares in exchange for all the outstanding shares of Xphase and management services of Xphase principals. Upon the achievement of certain pre-defined business development milestones, we will issue additional 3.5 million common shares to the shareholders of Xphase.

Pursuant to the share purchase agreement among Pacgen, Xphase and Xphase shareholders, we issued 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. 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. 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 Q2 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 Q2 2010, 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 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 Q2 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 upcoming 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 Q2 2010, we recorded a net loss of \$433,300 (\$0.01 per common share), compared to a net loss of \$642,454 (\$0.02 per common share) for the three months ended September 30, 2008 (“Q2 2009”). On a year-to-date basis, we recorded a net loss of \$642,303 (\$0.02 per common share), compared to a net loss of \$1,949,955 (\$0.06 per common share) for the same period in the preceding fiscal year. The decreased net losses in both periods were due to our reduced operating expenditures following the implementation of our cost programs in the preceding fiscal year.

Since we commenced operations in April 2004, we have accumulated a deficit of \$15,472,624 as at September 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 September 30, 2009, we had cash and cash equivalents of \$48,982 and a working capital deficiency of \$1,476,358. We believe the remaining cash on hand will finance our operations into calendar year 2010. However, given our working capital deficiency as at September 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.

Continued weakness in the global economy has led to a substantial reduction in capital in the credit markets. Smaller life science technology companies which are generally viewed as higher risk investments have been significantly affected. Given this challenging credit market environment, we continue to conserve cash through the Xphase Acquisition in exchange for management services as well as right to acquire AF-05. We are also in discussion with our vendors to defer payments while we continue to pursue all possible alternatives to secure additional capital to finance our operations.

Management is actively pursuing a number of business development leads in the emerging markets in Asia. These business development efforts are focused on securing collaborative or joint venture partners for our PAC-113 program and PAC-G31P program. Management is also screening for new programs to attract financing. In additions to these business development efforts, we are pursuing a number of equity and debt financing leads; however, we have encountered resistance from new and existing shareholders to raise additional funds due to our current outstanding liabilities. We have initiated discussions with our creditors to further reduce our liabilities in order to enhance our ability to raise funds. While management believes these efforts may lead to a near term financing, and 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 other 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 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 \$14,916 for Q2 2010, compared to \$155,264 for Q2 2009. On a year-to-date basis, research and development expenses for the six months ended September 30, 2009 (“YTD 2010”) were \$51,622, as compared to \$1,036,451 for the six months ended September 30, 2008 (“YTD 2009”). The decreases of research and development expenses in both periods were primarily due to our reduced development activities. We have deferred further development of our programs until we secured collaborative partners or joint venture partners.

The following provides a summary of the research and development expenditures by programs for the comparative three and six months ended September 30, 2009 and since inception:

Projects	For the three months ended		For the six months ended		Cumulative from Inception to September 30, 2009
	September 30, 2009	2008	September 30, 2009	2008	
PAC-113 (2005 – 2009)					
Expense	\$14,655	\$87,468	\$41,072	\$927,618	\$5,512,786
Recovery	—	—	—	—	(865,287)
	14,655	87,468	41,072	927,618	4,647,500
PAC-G31P (2007 – 2009)	261	67,175	10,550	101,618	2,110,154
Other Projects	—	621	—	7,215	210,996
	\$14,916	\$155,264	\$51,622	\$1,036,451	\$6,968,649

### *PAC-113*

PAC-113 development cost declined by \$72,813 in Q2 2010 as compared to those in Q2 2009. The decrease was mainly due to our decision to defer further development of PAC-113 until a collaborative partner is secured. The development expenditures in Q2 2010 covered primarily the maintenance of license and patents, while those in Q2 2009 covered primarily the costs associated with our Phase IIb study and the maintenance of license and patents.

The development cost was substantially decreased by \$886,546 in YTD 2010 as compared to those in YTD 2009. The significant reduction in development cost was due to the minimal development activities following the completion of Phase IIb clinical trial in June 2008. The development cost in YTD 2010 covered mainly the maintenance of license and patents, while those in YTD 2009 covered the cost associated with Phase IIb clinical trial, as well as the maintenance of license and patents.

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 comprises the cost associated with license and patent maintenance as well as stability studies.

### *PAC-G31P*

PAC-G31P research cost declined by \$66,914 in Q2 2010 as compared to those in Q2 2009. Research expenditure for both periods covered mainly the internal overhead associated with our research personnel. The research cost was decreased by \$91,068 in YTD 2010 as compared to those in YTD 2009. Research expenditure in YTD 2010 covered primarily the maintenance of patents, while those in YTD 2009 composed mainly of the internal overhead associated with our research personnel. The decrease for both periods was due to the reduced research activities associated with this project.

For the remainder of 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 comprises the cost associated with license and patent maintenance.

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

General and administration expenses were \$259,210 for Q2 2010, compared to \$298,815 for Q2 2009. On a year-to-date basis, general and administration expenses were \$313,691, compared to \$603,702 for the same period in the preceding fiscal year. General and administration expenses were comparable in Q2 2010, and were significantly lower in YTD 2010, as compared to the same periods in the preceding fiscal year. The decrease in general and administration expenses on a year-to-date basis was primarily attributable to the implementation of our cost control programs.

The following provides a summary of the general and administration expenditures for the comparative three and six months ended September 30, 2009 and since inception:

General and Administration Expenditures	For the three months ended		For the six months ended		Cumulative from
	2009	2008	2009	2008	Inception to September 30, 2009
Consulting and management fees	\$94,704	\$94,736	\$97,643	\$197,367	936,758
Market research and business development	58,490	—	58,490	—	179,728
Professional fees	16,960	35,400	21,941	74,490	1,006,105
Salaries and benefits	450	105,619	900	211,324	2,441,614
Travel and accommodation	36,051	18,069	38,630	29,825	376,037
Other general overhead	52,555	44,991	96,087	90,696	1,400,249
	<u>\$259,210</u>	<u>\$298,815</u>	<u>\$313,691</u>	<u>\$603,702</u>	<u>6,340,491</u>

Consulting and management fees were relatively the same in Q2 2010 and were lower in YTD 2010, as compared to those in the same periods in the preceding fiscal year. Consulting and management fees recorded in Q2 2010 were related to management fees of Xphase principals. Of the purchase price of Xphase Acquisition, \$189,407 was allocated to management services acquired and were amortized over a one year service period starting April 1, 2009.

Professional fees declined in both Q2 2010 and YTD 2010, as compared to those in the same periods in the preceding fiscal year, mainly due to our cost cutting measure by conducting the work internally whenever possible. Salaries and benefits also declined as a result of our reduced management salaries. All full-time positions have been replaced with management consultant positions which are compensated by stock based compensation. Market research and business development expenditures, as well as travel and accommodation expenditures increased in both Q2 2010 and YTD 2010, as compared to those in the same periods in the preceding fiscal year, primarily due to our expanded business development activities in our efforts to partner out our research and development programs and to license-in new programs.

For the remainder of Fiscal 2010, we expect our general and administration expenditures to be relatively the same as those incurred during the six months ended September 30, 2009. 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 compensations, a non-cash item included in operating expenses, attributable to research and development activities or general and administration activities are as follows:

	For the three months ended September 30,		For the six months ended September 30,		Cumulative from Inception to September 30,
	2009	2008	2009	2008	2009
Stock Based Compensation					
Research and development	\$63,433	\$34,806	\$38,814	\$47,450	436,172
General and administration	32,500	56,540	87,814	102,706	778,316
	\$95,933	\$91,346	\$126,628	\$150,156	1,214,488

The increase in stock based compensation in Q2 2010, as compared to the same period in the preceding year, was due to the new stock option grants for management services of Xphase principals as well as other personnel. Starting April 2009, our compensation package to internal personnel includes only stock based compensation. For their management services, in addition to stock option grants, Xphase principals also received our common shares from the Xphase Acquisition. The decrease in stock based compensation in YTD 2010, as compared to the same period in the preceding year, was mainly due to the increased number of stock options forfeited or cancelled.

For the remainder of Fiscal 2010, we expect our stock based compensation to be minimal as we have already recognized most stock based compensation including those new stock options granted to the Xphase principals and other personnel.

### ***Amortization***

Amortization was \$63,341 in Q2 2010, compared to \$66,307 in Q2 2009. Year-to-date amortization was \$126,527 compared to \$132,614 for the same period in the preceding fiscal year. Amortization related to technology, licenses and rights in Q2 2010 remained the same at \$59,244, compared to Q2 2009. The remaining amortization was related to property and equipment.

### ***Other Income (Loss)***

Other income was \$100 in Q2 2010, compared to other loss of \$30,722 in Q2 2009. On a year-to-date basis, other loss was \$23,835 compared to \$27,032 for the same period in the preceding fiscal year. The decrease in other loss for both periods was mainly due to an increase in foreign exchange gain, but this was offset by an increase in financing and interest expenses and a reduction in interest income. The financing and interest expenses of \$66,697 in Q2 2010 and \$136,713 in YTD 2010 were 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 increases in net foreign exchange gain for both periods were due to 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:

	2nd Quarter Ended September 30, 2009 ("Q2 2010")	1st Quarter Ended June 30, 2009 ("Q1 2010")	4th Quarter Ended March 31, 2009 ("Q4 2009")	3rd Quarter Ended December 31, 2008 ("Q3 2009")
Research and development	\$(14,916)	\$(36,706)	\$(87,804)	\$537,658
General and administration	(259,210)	(54,481)	(118,457)	(277,673)
Stock based compensation	(95,933)	(30,695)	40,879	(51,410)
Amortization	(63,341)	(63,186)	(64,895)	(66,307)
Other income (loss)	100	(23,935)	(80,710)	(163,966)
Future income tax recovery	—	—	—	—
Net loss for the period	(433,300)	(209,003)	(310,987)	(21,698)
Basic and diluted loss per common share	\$(0.01)	\$(0.01)	\$(0.01)	\$(0.00)

	2nd Quarter Ended September 30, 2008 ("Q2 2009")	1st Quarter Ended June 30, 2008 ("Q1 2009")	4th Quarter Ended March 31, 2008 ("Q4 2008")	3rd Quarter Ended December 31, 2007 ("Q3 2008")
Research and development	\$(155,264)	\$(881,187)	\$(1,071,903)	\$(431,197)
General and administration	(298,815)	(304,887)	(307,439)	(406,920)
Stock based compensation	(91,346)	(58,810)	(119,597)	(68,928)
Amortization	(66,307)	(66,307)	(63,905)	(68,661)
Other income (loss)	(30,722)	3,690	(129,095)	(7,358)
Future income tax recovery	—	—	27,722	12,079
Net loss for the period	(642,454)	(1,307,501)	(1,664,217)	(970,985)
Basic and diluted loss per common share	\$(0.02)	\$(0.04)	\$(0.05)	\$(0.03)

### 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 (iii) the implementation of our cost programs in different stages in the preceding two fiscal years.

Research and development expenditures were significantly reduced since Q4 2008 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) our decision, following the completion of the Phase IIb study in June 2008, to defer further development of all projects until collaborative or joint venture partners are secured. 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. 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 IIb clinical trial.

General and administration expenditures were in a declining trend, except Q2 2010, as a result of our cost control programs implemented in the preceding two fiscal years. The cost control programs involved (i) replacement of all full-time positions with consultant positions (ii) appointment of Chairman of our board of directors to act as interim President and Chief Executive Officer, for the period of November 2008 to August 2009, at no compensation, and (iii) elimination of all director fees effective February 2008. The increase of general and administration expenditures in Q2 2010, as compared to Q1 2010, was primarily due to the increased management fees following the appointment of Xphase principals as our management, and the increased business development cost associated with our partnering activities.

## LIQUIDITY AND CAPITAL RESOURCES

### *Sources and Uses of Cash*

Since inception to September 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 Q2 2010 was \$37,245, compared to \$350,771 for Q2 2009. Year-to-date cash used in operating activities was \$237,235 compared to \$1,199,118 for the same period in the preceding fiscal year. 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 cash used in operating activities in each of the current fiscal periods was primarily due to the decreased operating loss.

Cash used in investing activities for each of the periods in Q2 2010 and YTD 2010 was composed of the cash acquired from Xphase in April 2009 offset by the transaction costs in relation to the Xphase Acquisition. There was no cash used in investing activities in Q2 2009 and YTD 2009, and no cash provided by financing activities for the comparative three and six months ended September 30, 2009 and 2008.

As of September 30, 2009, we had available cash reserves comprised of cash and cash equivalents of \$48,982, compared to \$308,871 at March 31, 2009. We had a working capital deficiency of \$1,476,358 at September 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 September 30, 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	\$106,677	\$50,686	\$55,991	—	—
Clinical Research Agreements <sup>(1)</sup>	2,017,088	2,017,088	—	—	—
License Agreements <sup>(2)(3)</sup>	346,811	132,671	107,070	107,070	107,070
<b>Total</b>	<b>\$2,470,576</b>	<b>\$2,200,445</b>	<b>\$163,061</b>	<b>\$107,070</b>	<b>\$107,070</b>

- (1) The total commitment of \$2,177,088 reflects \$416,684 of commitments that are non-cancellable and \$1,600,404 of commitments that are cancellable should we decide to discontinue the related clinical research work.
- (2) Pursuant to the Demegen Sublicense, which relates to our PAC-113 licensed technology, we have a commitment to pay minimum annual royalties of US\$50,000 as 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 September 30, 2009 of CAD\$1.00 = US\$0.9340. All minimum royalties other than, \$7,000 for 2008 and \$50,000 for 2009, were paid as of September 30, 2009. We have obtained acknowledgement from the licensor that the outstanding minimum annual royalties of \$57,000 would be deferred until a financing is secured.
- (3) 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 related to the licensed technology PAC-G31P, to be performed at the University of Saskatchewan within 5 years of the term of the agreement. Of this commitment, \$334,097 has been paid as of September 30, 2009. The remaining balance of \$165,903 was due for funding by October 15, 2009. We have obtained acknowledgement from the licensor that this funding would be deferred until we secure a financing.

## **OUTSTANDING SHARE CAPITAL**

As of November 23, 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 September 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, joint-ventures, 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 titled "Risks and Uncertainties" in our annual MD&A for the year ended March 31, 2009 dated July 9, 2009 as well as the section titled "Risk Factors" in our Annual Information Form dated July 31, 2008.