

Interim Consolidated Financial Statements

Pacgen Biopharmaceuticals Corporation

(a development stage enterprise)

(Unaudited - expressed in Canadian dollars)

For the three and nine months ended December 31, 2009 and 2008

Notice to Reader

Management has compiled the unaudited interim consolidated financial statements of Pacgen Biopharmaceuticals Corporation consisting of the interim Consolidated Balance Sheets as at December 31, 2009 and the interim Consolidated Statements of Operations and Comprehensive Loss, Consolidated Statements of Cash Flows and Consolidated Statements of Shareholders' Equity (Deficiency) for the three and nine months ended December 31, 2009. The interim consolidated financial statements have not been reviewed or audited by the Company's auditors. All amounts are stated in Canadian Dollars.

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

Incorporated under the Business Corporation Act (British Columbia)

INTERIM CONSOLIDATED BALANCE SHEETS

[See Notes 1 and 2 – Going Concern and Basis of Presentation]

(Unaudited - expressed in Canadian dollars)

	December 31, 2009 \$	March 31, 2009 \$
ASSETS		
Current		
Cash and cash equivalents	30,107	308,871
Amounts receivable	3,054	15,155
Prepaid expenses and other	454,328	515,619
Total current assets	487,489	839,645
Deferred acquisition costs	—	3,775
Property and equipment <i>[note 7]</i>	57,123	67,874
Intangible assets <i>[note 8]</i>	343,090	765,229
Total assets	887,702	1,676,523
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	910,544	911,688
Other payable <i>[note 9]</i>	609,580	625,423
Convertible debentures <i>[note 10]</i>	598,932	318,831
Current portion of deferred leasehold inducement	5,187	6,916
	2,124,243	1,862,858
Convertible debentures <i>[note 10]</i>	—	213,000
Deferred leasehold inducement	—	3,459
Total liabilities	2,124,243	2,079,317
Commitments and contingencies <i>[notes 12 and 13]</i>		
Shareholders' equity (deficit)		
Share capital <i>[note 11]</i>		
Authorized:		
Unlimited number of common shares without par value		
Unlimited number of preferred shares without par value		
Issued and outstanding:		
Common shares	13,162,118	13,012,118
Contributed surplus <i>[notes 10 and 11(d)]</i>	1,542,146	1,415,409
Deficit	(15,940,805)	(14,830,321)
Total shareholders' equity (deficit)	(1,236,541)	(402,794)
Total liabilities and shareholders' equity	887,702	1,676,523

See accompanying notes

On behalf of the Board:

/s/ Kevin McGarry
Director/s/ Telvin Ju
Director

Pacgen Biopharmaceuticals Corporation
(a development stage enterprise)

**INTERIM CONSOLIDATED STATEMENTS
OF OPERATIONS AND COMPREHENSIVE LOSS**

(Unaudited - expressed in Canadian dollars)

	Three Months Ended December 31		Nine Months Ended December 31,		Cumulative from Inception to December 31,
	2009	2008	2009	2008	2009
	\$	\$	\$	\$	\$
EXPENSES					
Research and development	19,675	208,858	71,297	1,245,309	7,853,611
Research and development expense recovery <i>[note 9]</i>	—	(746,516)	—	(746,516)	(865,287)
	19,675	(537,658)	71,297	498,793	6,988,324
General and administration	103,445	277,673	417,136	881,375	6,443,936
Stock based compensation <i>[note 11(d)]</i>	109	51,410	126,737	201,566	1,214,597
Amortization	63,267	66,307	189,794	198,921	987,113
Write-down of intangible assets <i>[note 8]</i>	244,408	—	244,408	—	244,408
	430,904	(142,268)	1,049,372	1,780,655	15,878,378
OTHER					
Interest and other income	16,526	9,599	28,737	34,795	292,666
Financing and interest expenses	(65,541)	—	(202,254)	—	(254,836)
Loss on disposal of property and equipment	—	—	—	—	(15,609)
Foreign exchange gain (loss)	11,738	(173,565)	112,405	(225,793)	(322,648)
	(37,277)	(163,966)	(61,112)	(190,998)	(300,427)
Loss before income taxes	(468,181)	(21,698)	(1,110,484)	(1,971,653)	(16,178,805)
Future income tax recovery	—	—	—	—	238,000
Net loss and comprehensive loss for the period	(468,181)	(21,698)	(1,110,484)	(1,971,653)	(15,940,805)
Basic and diluted loss per common share	(0.01)	(0.00)	(0.03)	(0.06)	
Weighted average number of common shares outstanding	38,144,693	35,144,693	36,704,693	35,144,693	

See accompanying notes

Pacgen Biopharmaceuticals Corporation
(a development stage enterprise)

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited - expressed in Canadian dollars)

	Three Months Ended December 31,		Nine Months Ended December 31,		Cumulative from Inception to December 31,
	2009	2008	2009	2008	2009
	\$	\$	\$	\$	\$
OPERATING ACTIVITIES					
Loss for the period	(468,181)	(21,698)	(1,110,484)	(1,971,653)	(15,940,805)
Add items not affecting cash:					
Accretion of convertible debentures	22,923	—	67,102	—	75,379
Amortization	63,267	66,307	189,794	198,921	987,113
Deferred leasehold improvement	(1,729)	(1,729)	(5,187)	(5,187)	(13,256)
Future income tax recovery	—	—	—	—	(238,000)
Loss on disposal of property and equipment	—	—	—	—	9,089
Management fees paid by equity	47,352	—	142,056	—	142,056
Stock based compensation	109	51,410	126,737	201,566	1,214,597
Unrealized foreign exchange loss	(11,942)	180,174	(114,914)	216,407	187,956
Write-off of assets	—	—	—	—	29,887
Write-down of intangible assets	244,408	—	244,408	—	244,408
	(103,793)	274,464	(460,488)	(1,359,946)	(13,301,576)
Changes in non-cash working capital items relating to operations:					
Amounts receivable	3,264	(5,980)	12,224	(545)	140,564
Prepaid expenses and other	11,447	1,228	32,852	69,224	(497,557)
Accounts payable and accrued liabilities	40,472	(469,064)	66,176	(107,203)	629,966
Other payable	29,735	—	93,126	—	730,781
Cash used in operating activities	(18,875)	(199,352)	(256,110)	(1,398,470)	(12,297,822)
INVESTING ACTIVITIES					
Acquisition of IL Therapeutics Inc.	—	—	—	—	1,237,089
Acquisition of Xphase Pharmaceuticals Inc. [note 6]	—	—	(21,341)	—	(21,341)
Proceeds from disposal of property and equipment	—	—	—	—	5,775
Purchase of property and equipment	—	—	(1,313)	—	(180,516)
Purchase of intangible assets	—	—	—	—	(59,743)
Leasehold inducement	—	—	—	—	18,444
Cash provided by (used in) investing activities	—	—	(22,654)	—	999,708
FINANCING ACTIVITIES					
Issuance of share capital, net of share issuance cost	—	—	—	—	10,018,885
Issuance of convertible debentures for cash	—	—	—	—	614,500
Advance from related party	—	—	—	—	694,836
Cash provided by financing activities	—	—	—	—	11,328,221
Increase (decrease) in cash and cash equivalents	(18,875)	(199,352)	(278,764)	(1,398,470)	30,107
Cash and cash equivalents, beginning of period	48,982	239,573	308,871	1,438,691	—
Cash and cash equivalents, end of period	30,107	40,221	30,107	40,221	30,107

See accompanying notes

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**INTERIM CONSOLIDATED STATEMENTS OF
SHAREHOLDERS' EQUITY (DEFICIENCY)**

(Unaudited - expressed in Canadian dollars)

	Common Shares		Contributed	Deficit	Total
	Number	Amount	Surplus		
		\$	\$		
Balance, March 31, 2008	35,144,693	13,012,118	1,163,776	(12,547,681)	1,628,213
Stock based compensation	—	—	58,810	—	58,810
Net loss for the period	—	—	—	(1,307,501)	(1,307,501)
Balance, June 30, 2008	35,144,693	13,012,118	1,222,586	(13,855,182)	379,522
Stock based compensation	—	—	91,346	—	91,346
Net loss for the period	—	—	—	(642,454)	(642,454)
Balance, September 30, 2008	35,144,693	13,012,118	1,313,932	(14,497,636)	(171,586)
Stock based compensation	—	—	51,410	—	51,410
Net loss for the period	—	—	—	(21,698)	(21,698)
Balance, December 31, 2008	35,144,693	13,012,118	1,365,342	(14,519,334)	(141,874)

	Common Shares		Contributed	Deficit	Total
	Number	Amount	Surplus		
		\$	\$		
Balance, March 31, 2009	35,144,693	13,012,118	1,415,409	(14,830,321)	(402,794)
Stock based compensation	—	—	30,695	—	30,695
Net loss for the period	—	—	—	(209,003)	(209,003)
Balance, June 30, 2009	35,144,693	13,012,118	1,446,104	(15,039,324)	(581,102)
Shares issued pursuant to Xphase Acquisition	3,000,000	150,000	—	—	150,000
Stock based compensation	—	—	95,933	—	95,933
Net loss for the period	—	—	—	(433,300)	(433,300)
Balance, September 30, 2009	38,144,693	13,162,118	1,542,037	(15,472,624)	(768,469)
Stock based compensation	—	—	109	—	109,
Net loss for the period	—	—	—	(468,181)	(468,181)
Balance, December 31, 2009	38,144,693	13,162,118	1,542,146	(15,940,805)	(1,236,541)

See accompanying notes

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

For the three and nine months ended December 31, 2009 and 2008
(Unaudited - 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 unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for the next twelve months. 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 December 31, 2009, the Company has not generated any revenue from its operations and has accumulated a deficit of \$15,940,805 (March 31, 2009 - \$14,830,321). Therefore, the Company is considered to be in the development stage. The Company has a working capital deficiency of \$1,636,754 as of December 31, 2009 which is not sufficient to sustain operations over the next twelve months and the Company may be unable to continue realizing its assets and discharge its obligations in the normal course, all of which cast 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 global economic crisis in 2009 has led to a substantial reduction in capital in the credit markets, especially for companies in the development stage. Despite some signs of economic improvement in the general financial market, smaller life science technology companies, which are generally viewed as higher risk investments, continue to encounter difficulty in raising new capital. In the preceding fiscal year, the Company had taken cost cutting measures, closed a convertible debenture financing [note 10], and negotiated with its major vendor to reduce its liabilities [note 9]. In the current fiscal year, the Company continues to pursue all possible alternatives to secure additional financing.

The Company has actively pursued a number of business development leads in the emerging markets in Asia. These business development efforts have led to a collaborative research and development deal with Shanghai based New Summit Biopharma Co. (“New Summit Bio”). Under the terms of the collaborative research and development agreements, signed in January 2010, New Summit Bio will collaborate with the Company to raise funding and develop PAC-113 for the treatment of oral Candidiasis for commercialization in China. The Company will continue to pursue for new business development leads for PAC-113 regional rights, outside of China market, and PAC-G31P worldwide rights.

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

In additions to these business development efforts, the Company is also pursuing some equity financing leads. The Company encounters resistance from new and existing shareholders to raise additional funds due to its current outstanding liabilities, and has initiated discussions with its creditors to reduce or restructure its liabilities in order to enhance its ability to raise funds. While management believes these efforts may lead to a near term financing, there can be no assurance that such financing will be materialized or be completed on a timely basis to allow the Company to continue as a going concern. If the Company is unable to obtain new funding, it may be required to cease its operations in the near term.

2. BASIS OF PRESENTATION

These unaudited interim consolidated financial statements have been prepared on a basis consistent with the policies outlined in the Company's audited consolidated financial statements for the year ended March 31, 2009 except as described in note 3 below. These unaudited interim financial statements do not include all note disclosures and information required by Canadian GAAP for annual financial statements. Accordingly, they should be read in conjunction with the audited financial statements and notes thereto, for the year ended March 31, 2009. The results of operations for the three and nine months ended December 31, 2009 are not necessarily indicative of the results for the full fiscal year. All amounts herein are expressed in Canadian dollars unless otherwise specified.

3. CHANGES IN ACCOUNTING POLICIES

[a] Goodwill and Intangible Assets

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 Company adopted these standards commencing April 1, 2009. The adoption of these new standards did not have a material impact on the Company's consolidated financial statements.

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

[b] Credit Risk and Fair Value of Financial Assets and Financial Liabilities

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 financial periods ending on or after January 20, 2009 with retrospective application without restatement of prior periods. The Company adopted these standards commencing April 1, 2009. The adoption of these new standards did not have a material impact on the Company's consolidated financial statements.

[c] New Accounting Pronouncements

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. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

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.

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.

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**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**

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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 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, 2009.

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:

Financial Instrument	Classification	Measurement
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 three and nine months ended December 31, 2009.

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**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**

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5. FINANCIAL INSTRUMENTS AND RISK (cont'd.)

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. As of December 31, 2009, the Company has cash and cash equivalents consisted of cash on deposit with banks.

[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 three and nine months ended December 31, 2009 by \$1,872 and \$5,500, respectively. An opposite impact would have occurred to net loss and cash used in operations had interest rate decreased by one percent. 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. Based on the value of cash and cash equivalents during the three and nine months ended December 31, 2009, and assuming that all other variables remain constant, a one percent appreciation or deterioration of the interest rate would result in an increase or decrease of \$75 and \$681 in the Company's net loss and comprehensive loss, respectively. 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 obligations and 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.

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5. FINANCIAL INSTRUMENTS AND RISK (cont'd.)

[c] Currency risk (cont'd.)

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

	December 31, 2009 US\$	March 31, 2009 US\$
Cash and cash equivalents	5,638	14,802
Prepaid expenses	382,261	382,261
Accounts payable and accrued liabilities	448,163	413,679
Other payable	580,000	495,856
	1,416,062	1,306,598

Based on the above net exposures as at December 31, 2009, and assuming that all other variables remain constant, a five percent appreciation or deterioration of the Canadian dollar against the US dollar would result in a decrease or increase of \$33,646 (March 31, 2009 - \$32,319) 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 December 31, 2009, the Company had a working capital deficiency of \$1,636,754 (March 31, 2009 - \$1,023,213). 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.

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**NOTES TO INTERIM CONSOLIDATED
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6. ACQUISITION OF XPHASE PHARMACEUTICALS INC.

On August 11, 2009, the Company completed its acquisition of all issued and outstanding securities of Xphase Pharmaceuticals Inc. ("Xphase"). The acquisition provides the Company a 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. The acquisition also provides the Company with management services of Xphase principals at no additional compensation, other than grant of options priced at premium [note 11(d)]. The Company issued 3 million common shares of the Company 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, the Company will issue additional 3.5 million common shares to the shareholders of Xphase.

The acquisition has been accounted for using the purchase method of accounting and accordingly the results of operations have been included in the interim consolidated statement of operations and comprehensive loss from April 1, 2009, the effective commencement date of management services acquired. The allocation of the purchase price reflected in these interim consolidated financial statements is based on the financial position of Xphase as at April 1, 2009. The Company plans to complete its valuation relating to the final purchase price allocation at current fiscal year end, which when completed may result in an adjustment to the preliminary purchase price allocation reflected herein. The purchase price has been allocated to Xphase's identifiable assets and liabilities based on their estimated fair market value:

	Amount
	\$
Identifiable assets acquired:	
Cash	4,743
Other current assets	947
Other asset	189,407
Liabilities assumed:	
Accounts payable and accrued liabilities	(7,414)
Other liabilities	(11,600)
	<u>176,083</u>
Consideration:	
Equity securities	150,000
Transaction costs	26,083
	<u>176,083</u>

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6. ACQUISITION OF XPHASE PHARMACEUTICALS INC. (cont'd.)

The other asset, being a residual amount, represents prepaid management fees to Xphase principals for their services and is being amortized on a straight-line basis over the term of the services of one year. In accordance to the licensing arrangement between Xphase and Institute of Material Medica, Chinese Academy of Medical Science & Peking Union Medical College, the transfer of AF-05 technology license requires Xphase to exercise its acquisition right and pay initial licensing fees of US\$450,000. The Company has deferred its decision to exercise the right until it completes a financing; hence, has not allocated any portion of the purchase price to the right to acquire AF-05.

7. PROPERTY AND EQUIPMENT

	Cost \$	Accumulated Amortization \$	Net Book Value \$
December 31, 2009			
Computer equipment and software	46,919	36,395	10,524
Leasehold improvement	41,346	18,667	22,679
Office furniture and equipment	44,415	20,495	23,920
	132,680	75,557	57,123
March 31, 2009			
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
	131,368	63,494	67,874

8. INTANGIBLE ASSETS

	December 31, 2009 \$	March 31, 2009 \$
Technology, licenses and rights		
Cost	569,742	1,477,151
Accumulated amortization	226,652	711,922
	343,090	765,229

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8. INTANGIBLE ASSETS (cont'd.)

During the quarter ended December 31, 2009, the net book value of PAC-G31P license of \$244,408 has been written off to reflect the impairment in value of this license given the uncertainty surrounding for the funding of this project. As of December 31, 2009, the Company has not secured any collaborative partner or new funding to continue the development of PAC-G31P. The remaining net book value of \$343,090 as of December 31, 2009 is related to PAC-113 program of which the Company is in collaboration with a partner, New Summit Bio.

9. 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. As part of this settlement, the Company received a credit note of approximately US\$604,000 and made an initial payment of US\$128,000 in the fiscal year ended March 31, 2009. The Company agreed to settle the remaining balance by installment payments.

Pursuant to the settlement agreement, the Company is obligated to pay minimum installment payments of US\$150,000 (approximately \$158,000), US\$150,000 (approximately \$158,000) and US\$280,000 (approximately \$294,000) on July 15, 2009, October 15, 2009 and December 30, 2009, respectively. In addition, 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 \$526,000), 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. As of December 31, 2009, the Company recorded interest payable of US\$8,523.

As of December 30, 2009, the principal amount of US\$580,000 (approximately \$610,000) and interest of US\$8,523 (approximately \$9,000) were due for payment in full. The Company is in discussion with the vendor to extend its repayment term, and to revise certain settlement terms should the Company successfully secure new funding. While management believes that its ongoing communication with the vendor has kept the Company in good terms, there can be no assurance that the vendor would not demand full repayment in the next twelve months, which would have significant impact on the Company's ability to continue as a going concern.

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10. 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.

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

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

⁽²⁾ The 2nd tranche of the Offering was closed on March 30, 2009 with final completion on April 14, 2009.

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 \$1.05 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.

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10. CONVERTIBLE DEBENTURES (cont'd.)

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:

Allocation	Amount
	\$
Face value	614,500
Contributed surplus	(90,946)
	<u>523,554</u>

The Company incurred legal and professional fees of \$34,005 associated with the financing. These financing costs were charged as expenses during the prior quarters in the current fiscal year and the fiscal year ended March 31, 2009. As of December 31, 2009, the convertible debentures had a fair value of \$598,932.

11. SHARE CAPITAL

[a] Common shares

	Number of Shares	Amount \$
Authorized		
Unlimited number of common shares without par value		
Balance, March 31, 2009	35,144,693	13,012,118
Issuance pursuant to Xphase Acquisition	3,000,000	150,000
Balance, December 31, 2009	38,144,693	13,162,118

[b] Preferred shares

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

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11. SHARE CAPITAL (cont'd.)

[c] Common share purchase warrants

At December 31, 2009 and March 31, 2009, the Company had 4,656,933 of common share purchase warrants outstanding. Details of the common share purchase warrants are summarized as follows:

Date of Expiry	Exercise Price	Number of Warrants
March 16, 2013	\$0.30	4,622,733
March 16, 2010 ⁽¹⁾	\$0.22	34,200
Balance, December 30, 2009 and March 31, 2009	\$0.30	4,656,933

⁽¹⁾ Upon exercise, each Broker Warrant will convert to one common share, and one common share purchase warrant exercisable into one additional common share at \$0.30 per share until March 16, 2013. After giving effect to the conversion of these Broker Warrants, there are 4,691,133 common share purchase warrants outstanding, at an average exercise price of \$0.30, as of December 31, 2009 and March 31, 2009.

[d] Stock options

On August 22, 2006, the Company adopted a stock option plan, which was amended on September 2, 2009 (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.

As of December 31, 2009, the Company had 3,010,000 stock options outstanding granted to employees, officers, directors, consultants and scientific advisory board members. Details of stock option transactions for the period ended December 31, 2009 are summarized as follows:

	Number	Weighted Average Exercise Price \$
Balance, March 31, 2009	1,813,333	0.99
Granted	1,910,000	0.10
Forfeited or cancelled	(713,333)	0.89
Balance, December 31, 2009	3,010,000	0.45

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11. SHARE CAPITAL (cont'd.)

[d] Stock options (cont'd.)

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

Exercise Price	Options Outstanding			Options Exercisable	
	Number of Common Shares Issuable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Number of Common Shares Issuable	Weighted Average Exercise Price (\$)
\$0.10	1,910,000	5.07	0.10	1,910,000	0.10
\$0.63	150,000	5.41	0.63	106,666	0.63
\$1.05	280,000	4.03	1.05	280,000	1.05
\$1.16	670,000	4.74	1.16	640,000	1.16
	3,010,000	4.92	0.45	2,936,666	0.44

Date of Expiry	Exercise Price	Number of Options Outstanding	Number of Options Exercisable
August 22, 2014	\$1.05	150,000	150,000
August 22, 2014	\$1.16	550,000	550,000
March 6, 2012	\$1.05	80,000	80,000
March 6, 2015	\$1.05	50,000	50,000
March 6, 2015	\$1.16	120,000	90,000
May 31, 2015	\$0.63	150,000	106,666
July 28, 2014	\$0.10	1,590,000	1,590,000
July 28, 2017	\$0.10	320,000	320,000
Balance, December 31, 2009		3,010,000	2,936,666

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12. COMMITMENTS

[a] Operating leases

The Company has entered into lease agreements for its office premises and office equipment in Canada for terms of up to five years expiring on September 30, 2010. Future minimum annual lease payments under the leases are as follows:

	\$
2010	32,140
2011	50,131
2012	—
2013	—
2014	—
	<hr/> 82,271 <hr/>

[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 \$1,978,610 for the fiscal year ending March 31, 2010. Of these commitments, \$6,775 are non-cancellable. The remaining commitments of \$1,971,835 are cancellable, including those commitments that require forfeiting of prepaid amounts of \$401,757 if commitments are cancelled.

[c] License agreements

[i] Pursuant to a license agreement with Demegen, Inc. (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. The Company paid US\$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 US\$7,000 for 2008 and the minimum royalty payment of US\$50,000 for 2009 would be deferred. The Company is in discussion with the licensor to arrange for settlement of the outstanding royalty of US\$57,000. While management believes that its ongoing communication with the licensor has kept the Company in good terms, there can be no assurance that the licensor would not demand full payment or return of the Demegen Sublicense in the near term. The Company's research and collaboration with New Summit Bio is contingent upon its ability to maintain the Demegen Sublicense in good terms.

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12. COMMITMENTS (cont'd.)

[c] License agreements (cont'd.)

[ii] Pursuant to a license agreement between the Company's wholly owned subsidiary, IL Therapeutics Inc., 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. As of December 31, 2009, the Company has paid \$334,097 and accrued \$60,000 of contract research fees for research work done by the university. The remaining balance of \$105,903 was due for commitment by the Company on October 15, 2009. The Company is in discussion with the university to waive the remaining funding commitment of \$105,903, and to arrange for settlements of the outstanding research contract fees of \$60,000 and patent reimbursements of \$107,175. While management believes that its ongoing communication with the university has kept the Company in good terms, there can be no assurance that the university would not demand immediate funding commitment, amount outstanding, or return of the US License in the near term.

13. 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.

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14. 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.

15. RELATED PARTY TRANSACTIONS

There were no related party transactions during the three and nine months ended December 31, 2009 and 2008.

16. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to confirm with the presentation adopted in the current period.

17. SUBSEQUENT EVENTS

- [a] Subsequent to December 31, 2009, the Company continues to seek new capital 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 be materialized or be completed on a timely basis and on favourable terms. If the Company is unable to obtain new funding, it may be required to cease its operations in the near term.
- [b] The convertible debentures in the aggregate principal amount of \$364,500 were due for maturity on February 3, 2010. The Company notified these convertible debenture holders that repayment of the principal amount together with interest payment of \$23,038 would be deferred. The Company is in discussion with these convertible debenture holders to settle the outstanding amount with common shares of the Company. While management believes that its ongoing communication with the convertible debenture holders has kept the Company in good terms, there can be no assurance that they would not demand full payment in the near term. This would have significant impact on the Company's ability to continue as a going concern.