

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

The statements contained in the following Management's Discussion and Analysis of Financial Condition and Results of Operations of Akela Pharma (formally LAB International Inc.) ("Akela" or the "Company"), other than statements of fact that are independently verifiable at the date hereof, may be forward-looking statements regarding the industry in which Akela operates and the Company's expectations as to its future performance, liquidity and capital resources. Forward-looking statements look into the future and may include such words as "plans", "trends", "anticipates", "should", "estimates", "expects", "believes", "indicates", "targeting", "suggests" and similar expressions. This MD&A contains forward-looking statements about Akela's objectives, strategies and financial condition, as well as statements with respect to our beliefs, expectations, estimations and intentions. These "forward-looking" statements are based on current expectations and various factors and assumptions. Accordingly, these statements entail various risks both known and unknown, including those set forth in the "Risks and Uncertainties" section of this document. Consequently, actual future results may differ materially from the anticipated results expressed in the forward-looking statements. It is important to note that, unless otherwise indicated, forward-looking statements in this MD&A describe our expectations as of March 28, 2008. We assume no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or for any other reason.

This analysis explains the material variations in the consolidated statements of operations, financial position and cash flows of Akela for the three and twelve -month periods ended December 31, 2007 and the three and twelve-month periods ended December 31, 2006.

This document should be read in conjunction with the audited consolidated financial statements of Akela and related notes included therein which have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") for the years ended December 31, 2007 and December 31, 2006. All amounts are presented in thousands of US dollars unless otherwise indicated.

History and Development

Our History

We started as LAB Gesellschaft für pharmakologische Untersuchungen GmbH, a contract research organization ("CRO") established by Dr. Halvor Jaeger in Germany in 1979. We opened our first North American operation in 1982 in New Jersey and our first Canadian operation in Vaudreuil (near Montréal), Québec in 1992. In 1996, the German operations were sold and its former subsidiary in Canada became the headquarters. The clinical CRO business was sold in 1999, and from 1999 to 2002, we focused on increasing its preclinical CRO operations.

On May 9, 2002, then known as LAB International Holdings, Inc. ("LAB Holdings"), we went public by way of a reverse take-over transaction and became listed on the TSX. Our name was changed to LAB International Inc. The objective of the reverse take-over was to facilitate the growth of our CRO activities as well as to enable us to start developing our own pipeline of therapeutic products. Over the next five years, we completed a number of private placements and acquisitions to grow our pipeline and CRO activities. In June 2007, our name was changed to Akela Pharma Inc.

Corporate Reorganization and Sale of Contract Research Organization Business

As a result of various acquisitions, we operated two distinct business units, Pharma and Contract Research. The Pharma business was developing and manufacturing novel inhalation therapeutic products. The Contract Research business engaged in providing CRO services to the pharmaceutical and biotechnology industry and consisted of four separate wholly-owned subsidiaries in Canada, Hungary, Denmark and California. This business model was unique in the pharmaceutical industry and was based upon using our ongoing access to the capital generated by Contract Research to fund the development of novel therapeutics for the inhalation market by Pharma.

On May 24, 2006, we incorporated LAB Research Inc. (“LRI”). Between June 30, 2006 and August 3, 2006, we effected a corporate reorganization to facilitate a spin-off of the Contract Research business. Between August and November 2006, we sold all of our holdings in LRI.

Other Recent Events

On March 27, 2008, we concluded a public offering of 8,625,000 units, each unit consisting of one common share and one-half of one common share purchase warrant, for aggregate proceeds of Cdn \$10,350,000. Each whole warrant is exercisable to purchase one common share at a price of Cdn \$1.50 per share and expires three years from the closing date subject to our right to accelerate the expiry date of the warrants in certain events. Expenses in connection with the offering are expected to be approximately Cdn \$1.0 million. In addition we granted compensation options to the underwriters to purchase 525,000 common shares at Cdn \$1.20 per share that expire three years from the closing date. We have also granted the underwriters an option to purchase 603,750 common shares at a price of Cdn \$1.20 per share that expires two years from the closing date.

On January 25, 2007, we completed the acquisition of Formulation Technologies, L.L.C. (“PharmaForm”). The aggregate purchase price was as follows:

	Cash plus Transaction Costs	Value of Common Shares	Number of Common Shares	Total Value of Consideration
Payment at Closing	\$ 8,620	\$ 4,379	862,791	\$ 12,999
Phase II Distribution	-	4,074	1,222,284	4,074
	\$ 8,620	\$ 8,453	2,085,075	\$ 17,073

The phase II distribution is required to be made if PharmaForm's gross revenue (as defined in the PharmaForm acquisition agreement) within 12 months of January 1, 2007 equals or exceeds \$10 million, within 18 months equals or exceeds \$15 million or within 24 months equals or exceeds \$20 million. At December 31, 2007, this milestone was reached and the associated payment in common stock will take place in the first quarter of 2008. Additional consideration is payable by us upon completion of certain milestones relating to PharmaForm’s drug development programs. PharmaForm’s results of operations are consolidated from date of acquisition.

On October 10, 2007, our issued and outstanding Common Shares were consolidated on the basis of one (1) post-consolidation Common Share for every seven (7) pre-consolidation Common Shares. All references to common shares have been adjusted to reflect the reverse stock split.

Our Business

We are an integrated product development company primarily focused on therapeutics for pain utilizing our proprietary drug delivery technologies.

Fentanyl TAIFUN®

Our lead product candidate is Fentanyl TAIFUN®, a fentanyl formulation specifically designed to be delivered with our TAIFUN® Multi-Dose Inhaler. We are developing Fentanyl TAIFUN® as a rapid-acting inhaled opioid analgesic for treatment of break-through cancer pain.

Break-through cancer-related pain has a severe impact on a patient’s quality of life and can occur even if the individual is taking chronic pain medication on a regular basis. Break-through pain is a common component of chronic pain and is characterized by its rapid onset, intensity and relatively short duration. These intermittent flare-ups of intense pain “break-through” the effect of chronic pain medication. We believe currently available therapeutics targeted at break-through cancer pain are inadequate because of their higher dosage of fentanyl and comparatively longer time to onset. The current leading products in this market segment are Cephalon’s Actiq® lozenge and Fentora® buccal tablet, both containing fentanyl as the active compound. According to data reported by the American Cancer Society, approximately 800,000 cancer patients in the United States will experience break-

through pain in 2007. Data from EvaluatePharma shows that worldwide fentanyl sales in 2006 were U.S. \$2.4 billion.

Our Phase IIb clinical trial, completed in August 2007, showed the median time to significant pain relief for patients using our Fentanyl TAIFUN® was 5.2 minutes. This result was statistically significant versus placebo (p=0.007). We believe this offers significant clinical benefits for patients and physicians due to its rapid onset compared to other non-injectable therapies for break-through cancer pain. We have an open Investigational New Drug (“IND”) submission for Fentanyl TAIFUN®, which was submitted to the U.S. Food and Drug Administration (“FDA”) in March 2006. We had an end-of-Phase II meeting with the FDA in August 2007 to present the data obtained and are now finalizing the design of the Phase III program required for submission of a New Drug Application (“NDA”).

On February 4, 2008, we announced that we had received notice from the FDA that, due to GLP deviations, the six month inhalation toxicology studies of Fentanyl TAIFUN® dry powder inhaler performed for us on dogs and rats by a CRO were deemed invalid. No toxicological reasons were cited. We intend to repeat the inhalation toxicology studies in their entirety in the United States using a different CRO and those studies are tentatively scheduled to restart in 8 to 10 weeks. The cost of the repeated studies is estimated to be \$4.5 million. We are seeking to recover the costs incurred by us for the invalidated studies from the CRO that performed them, but there is no assurance that we will be successful. We will be concurrently conducting our Phase III clinical trials outside the United States, primarily in Europe and Asia. We anticipate filing the related NDA in Europe during the first half of 2010 and in the United States in the second half of 2010. Our objective is to commercialize Fentanyl TAIFUN® in Europe during the first half of 2011 and in the United States during the first half of 2012.

We believe, based upon the results of our clinical trials to date, that our Fentanyl TAIFUN® product candidate, if approved by regulatory agencies, will deliver much faster onset of pain relief from break-through cancer pain at lower dosages than other non-injectable products currently indicated for break-through cancer pain.

We have entered into development and license agreements for our Fentanyl TAIFUN® inhaler. Under these agreements, we have granted development, marketing and distribution rights in specified world markets in return for co-development fees in the form of up-front payments, fees for development activities and payments tied to meeting development milestones. Also under the agreements, we will earn revenues for supplying the finished product, along with royalties on future sales, once commercialization begins.

We currently have a signed agreement with Teiku Seiyaku Co. Limited for the South Korean, Chinese (excluding Hong Kong and Taiwan) and Japanese markets.

In addition, we signed a licensing and development agreement with Janssen Pharmaceutica NV for Fentanyl TAIFUN. The licensing agreement covers the European Union, Eastern Europe, Russia, the Middle East and Africa. We will collaborate with Janssen Pharmaceutica to develop the product for the initial indication of break through cancer pain. We will manufacture and the Janssen Pharmaceutica companies will market and distribute the product. Under the terms of the agreement, we received a signing fee of \$10.7 million (€8.0 million) and we can receive up to an additional \$74.4 million (€55.0 million) for meeting development, regulatory, and commercial sales milestones and could receive royalty revenues and revenues from the sales of the product to Janssen Pharmaceutica.

In December 2007, we extended the territory coverage of the initial license and development agreement with Janssen Pharmaceutica NV to include Canada and received a signing fee of \$1.1 million. All other commercial and contractual conditions remain in effect.

EDACS™

We have developed a proprietary abuse-resistant delivery platform, which we call EDACS™, or Extruded Deterrence of Abusable Controlled Substances, to address opioid abuse. We initiated a Phase I clinical trial on March 2, 2008 and expect to rely on a Section 505(b)(2) NDA approval process with the FDA, although no submissions have been made to date. For a description of the Section 505(b)(2) NDA approval process, see “Risk Factors – FDA approval for our product candidates in the United States could be delayed if our competitors obtain FDA approval for a competitive product before we do.” EDACS™ is manufactured by hot-melt extrusion of a

homogeneously blended powder that can be formulated to provide a variety of dosing options including once-a-day extended pain release. We believe that our technology is superior to other approaches for abuse deterrence because products manufactured with EDACS™ are crush resistant and slow to dose-release in alcohol. In addition, our product candidates do not contain opioid antagonists, such as naltrexone, which we believe may be vulnerable to unwanted leaking of the antagonist, thereby reducing the effect of the opioid. Our product candidates are intended to compete with the current market-leading oral controlled-release opioid products, including Oxycontin®, Avinza® and Opana®.

Abuse of opioid pain medications is a significant medical and social problem. According to the National Survey on Drug Use and Health published in 2007 by the United States Substance Abuse and Mental Health Services Administration, during 2006 approximately 5.2 million people in the United States used prescription pain relievers for nonmedical purposes, an increase from the estimated 4.7 million in 2005. Current dosage forms of prescription pain relievers are often abused by dissolving them in alcohol or crushing and inhaling the tablets.

Other Product Candidates

In addition to our pain product candidates, our non-pain product candidates and our platform technologies include:

- Growth Hormone Releasing Hormone (“**GHRH**”)—Our growth hormone releasing hormone is a synthetic analog of the natural human growth hormone releasing hormone, and is considered a new chemical entity. Our GHRH recently completed a pilot Phase II clinical trial outside the United States for the treatment of malnutrition associated with pre-dialysis stage chronic renal failure. The compound has been shown to have very high affinity for the pituitary GHRH receptor, and has a long circulating half life.
- Calcitonin Gene Related Peptide (“**CGRP**”)—Our CGRP is a novel therapeutic currently in Phase IIb development outside the United States for the treatment of asthma. CGRP is a natural peptide (37 amino acids) produced in the lung in response to allergic stimuli. Unlike current asthma drugs, CGRP has been shown to possess a combination of bronchodilatory, bronchoprotective and anti-inflammatory properties in several preclinical animal models of allergic asthma. From a therapeutic point of view, if validated in human clinical trials, CGRP has the potential to become the first drug with these properties.

To date, no submissions have been made to the FDA with respect to GHRH or CGRP.

Contract Services

We operate a contract manufacturing and research and development operation under the name PharmaForm. PharmaForm operates a 50,000 sqft. facility located in Austin, Texas providing drug formulation solutions, limited run drug manufacturing and product development services to mid-sized pharmaceutical and biotech companies. The specific types of service offered by PharmaForm include;

- Specialty drug manufacturing and formulation
- Drug development
- Process optimization
- QC testing / methods validation
- Analytical methods development
- Stability, storage and testing
- Consulting (IP validation and contestation)

Our Strategy

Our goal is to become an integrated product development company with a diversified product portfolio based on multiple drug delivery platforms. We intend to:

- *Focus on pain*—We believe the pain market represents a substantial near-term opportunity as many existing therapeutics, such as fentanyl, have the potential to be delivered by inhalation technology and lead to improved clinical benefit. In addition, given the prevalence of opioid abuse, deterrent products are likely to be in demand. We believe our drug delivery technologies and formulation expertise will allow us to develop products that will meet these unmet medical needs.
- *Pursue 505(b)(2) approvals*—We have selected the drugs incorporated in our proprietary delivery technologies, in part, due to their previously demonstrated safety and efficacy record in treating pain. We believe this will allow us to utilize the Section 505(b)(2) approval process with the FDA that may enable us to bring our product candidates to market more rapidly by relying for approval on studies conducted by others for which we have not obtained a right of reference.
- *Leverage our drug delivery expertise*—We believe our proprietary technologies and drug delivery expertise will allow us to develop differentiated products that are faster acting, safer or less abusable than currently approved products. We intend to continue to identify therapies where our technology platform and expertise can be applied to improve the standard of care for patients.
- *Maximize partnership opportunities*—We intend to enter into partnering arrangements with international pharmaceutical companies to market our product candidates worldwide. For our non-core product candidates, such as CGRP and GHRH, we intend to enter into partnership arrangements to advance clinical development prior to initiation of pivotal clinical trials.
- *Actively develop, in-license or acquire complementary products*—We will continue to pursue the in-house development of additional product candidates complementary to our existing portfolio. We evaluate in-licensing and acquisition opportunities to broaden our pipeline in the core therapeutic areas and drug delivery platforms, as demonstrated by our recent acquisition of PharmaForm.
- *Expand our PharmaForm Contract Services*—We plan to expand our contract research and development services at PharmaForm through investments in equipment and personnel that will result in increased cash flows to offset our ongoing development costs.

Liquidity

Our cash and cash equivalents at December 31, 2007 totaled \$6.7 million. On March 27, 2008 we concluded a public offering for aggregate proceeds of Cdn \$10.4 million. We believe that our available cash, expected interest income, potential funding from partnerships and licensing agreements, and access to capital markets should be sufficient to finance our operations for the ensuing fiscal year. We have and will continue to incur significant net losses as we develop our products. To fund these investments, we are pursuing various funding alternatives. We believe that our available cash, expected interest income, potential funding from partnerships and licensing agreements and access to capital markets should be sufficient to finance our operations for the ensuing fiscal year.

If sufficient capital is not available, we may be required to delay, reduce the scope of, eliminate or divest of one or more of our clinical trials and/or research and/or development projects, any of which could have a material adverse effect on our business, financial condition, and results of operations. We may also seek collaborators for our product candidates at an earlier stage than otherwise would be desirable and on terms that are less favorable than might otherwise be available. We may be required to relinquish or license on unfavorable terms our rights to technologies or product candidates that we otherwise would seek to develop or commercialize ourselves.

We cannot be certain that additional funding will be available on acceptable terms, or at all. To the extent that we raise additional funds by issuing equity securities, our shareholders may experience significant dilution. Any debt financing, if available, may involve restrictive covenants, such as limitations on our ability to incur additional indebtedness, limitations on our ability to acquire or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business.

Operating Results

Basis of Presentation

As of January 1, 2007, our functional currency is the US dollar. Historically, we have reported our financial performance in Canadian dollars. All opening assets and liabilities were translated into US dollars using the exchange rate in effect on January 1, 2007. For comparative purposes, historical financial statements and notes thereto up to and including December 31, 2006 have been restated into US dollars as if the Company had adopted the US dollar as its reporting currency for those periods.

The change in the functional currency for the prior periods resulted in a currency translation adjustment of \$3,110 as of December 31, 2006, which is reflected in other comprehensive income, a separate component of shareholders' equity.

The Company's Board of Directors, as authorized by the shareholders, declared effective October 10, 2007 a 1-for-7 reverse stock split, resulting in every seven shares of common stock being combined into one share of common stock. The stock split affects all of the Company's outstanding stock, stock options and warrants outstanding on the record date. The consolidated financial statements and all share data in this MD&A have been retroactively adjusted to reflect the stock split for all periods presented.

Three-months ended December 31, 2007

As a result of the PharmaForm Acquisition, our 2007 operating results are distinctly different from our 2006 operating results. This is principally because the acquisition of PharmaForm resulted in a new revenue and cost base starting in late January 2007.

	<u>2007</u>	<u>2006</u>
	<u>Consolidated</u>	<u>Consolidated</u>
Revenues	\$4,705	1,296
Direct costs	2,363	-
Selling, general and administrative	3,525	2,254
Research and development	2,383	3,873
Stock-based compensation	169	296
Amortization expense	1,124	558
Interest on long-term debt	54	(183)
Foreign exchange	127	539
US listing charges	3,988	-
Restructuring	-	3,859
Gain on disposal of LAB Research Inc.	-	(11,481)
Share in net income of a company subject to significant influence	-	(141)
Income taxes	(146)	2,465
Net loss	<u>(\$8,882)</u>	<u>(743)</u>

Revenues

We derive our revenues from licensing and co-development agreements and through providing contract research services such as drug formulation, drug development and limited run drug manufacturing for pharmaceutical and biotech companies. Revenues for the three-months ended December 31, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Co-development revenue	\$ 530	\$ 834	\$ (304)
Contract services revenue	4,044	-	4,044
Interest revenue	131	462	(331)
Total revenue	<u>\$ 4,705</u>	<u>\$ 1,296</u>	<u>\$ 3,409</u>

Co-development revenue. We have entered into development and license agreements for our Fentanyl TAIFUN® inhaler. Under these agreements, we have granted development, marketing and distribution rights in specified world markets in return for co-development fees in the form of up-front payments, fees for development activities and payments tied to meeting development milestones. Also under the agreements, we will earn revenues for supplying the finished product, along with royalties on future sales, once commercialization begins. We currently have agreements for the South Korean, Chinese (excluding Hong Kong and Taiwan) and Japanese markets. In June 2007, we signed a licensing and development agreement with Janssen Pharmaceutica NV for Fentanyl TAIFUN®. The licensing agreement covers the European Union, Eastern Europe, Russia, the Middle East and Africa. We will collaborate with Janssen Pharmaceutica to develop the product for the initial indication of break through cancer pain. We will manufacture and the Janssen Pharmaceutica will market and distribute the product. Under the terms of the agreement, we received a signing fee of \$10.7 million (€8.0 million) which has been deferred and is being recognized rateably over the estimated development period. In addition, we can receive up to an additional \$74.4 million (€55.0 million) for meeting development, regulatory, and commercial sales milestones and could receive royalty revenues and revenues from the sales of the product to Janssen Pharmaceutica. In December 2007, we extended the territory coverage of the initial license and development agreement with Janssen Pharmaceutica NV to include Canada for a signing fee of \$1.1 million. All other commercial and contractual conditions remain in effect.

Co-development revenue decreased to \$0.5 million for the three-months ended December 31, 2007 from \$0.8 million for the three-months ended December 31, 2006. The decline in co-development revenue reflects the completion of clinical supplies manufacturing and related testing performed on behalf of Teikoku Seiyaku Co. Ltd., which occurred during the third quarter of 2007.

Contract services revenue. Contract services revenue was \$4.0 million for the three-months ended December 31, 2007 and included approximately \$1.3 million in special litigation services. This contract services revenue base was acquired with the acquisition of PharmaForm in January 2007 therefore no such revenue was recorded in 2006. Revenue from service contracts with milestone delivery terms are recognized as milestones are reached. As such, contract services revenue can fluctuate between quarters.

Interest revenue. Interest revenue relates to interest earned on invested cash balances. The decrease in interest revenue is due to a decrease in invested cash balances.

Expenses

Direct costs. Direct costs for the three-months ended December 31, 2007 related to the costs associated with providing contract services and include the cost of raw materials, direct and indirect labor, supplies and related equipment and facility overhead. These contract services are associated with activities acquired in the acquisition of PharmaForm in January 2007; therefore no such expense was recorded in 2006.

Selling, general and administrative (SG&A). SG&A expenses consisted of salary and benefits for the executive, accounting, administrative and business development personnel, professional fees and other corporate expenses. SG&A expense for the three-months ended December 31, 2007 increased to \$3.5 million from \$2.3 million. SG&A increased as a result of the acquisition of PharmaForm and additional salary and overhead associated with supporting the expansion of our development operations. These costs were offset, in-part, by reductions in SG&A associated with the down-sizing of our Finnish operation which was completed late in the third quarter.

Research and Development (R&D). R&D expenses consisted primarily of third-party pre-clinical and clinical trial providers, salary and benefits for scientists and technicians, testing material, consultants and related overhead. R&D expense for the three-months ended December 31, 2007 decreased to \$2.4 million from \$3.9 million. The decrease in R&D expenses is primarily due to a decline in third-party pre-clinical and clinical trial provider fees, salaries and benefits, material and overhead primarily associated with the development and advancement of our Fentanyl TAIFUN® product which completed Phase II trial programs during the third quarter.

Stock-based compensation. Stock-based compensation expense relates to stock options granted to employees. Employee stock options are accounted for using the fair value method. Under this method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period. Stock-based compensation for the three-months ended December 31, 2007 decreased to \$0.2 million from \$0.3 million.

Amortization expense. Amortization expense includes amortization of property and equipment as well as intangible assets. Amortization expense increased to \$1.1 million for the three-months ended December 31, 2007 from \$0.6 million for the three-months ended December 31, 2006. The increase relates to the January 2007 acquisition of PharmaForm, which resulted in \$8.0 million in intangible assets which are being amortized over a period of between three and five years and \$2.8 million in property and equipment which are being amortized over a period of between two and ten years.

Interest expense. Long-term interest expense relates to capital loans, notes payable and various capital lease obligations.

Foreign Exchange. Although our functional currency is the US dollar, a significant portion of our assets and liabilities are in Canadian dollars and Euros. The decline in foreign exchange losses over the previous year reflected the strengthening of the Euro and Canadian dollar to the US dollar.

US listing charges. During the fourth quarter of 2007, \$4.0 million of deferred corporate transaction costs associated with a proposed share listing and financing in the US were expensed due to unfavorable market conditions.

Year ended December 31, 2007

As a result of the LRI Spin-off and PharmaForm Acquisition, our 2007 operating results are distinctly different from our 2006 operating results. This is principally because the LRI pre-clinical contract research services business, which was disposed of in the LRI Spin-off, provided a revenue and expense base substantially different from our continuing operations. In addition, the acquisition of PharmaForm resulted in a new revenue and cost base starting in late January 2007. Consequently, the following discussion of our consolidated operating results for the twelve-months ended December 31, 2007 is based on comparisons to its relevant historical segmented results which are referred to below as the "Pharma" segment. The term "Contract Research" is used to refer to the activities constituting our former LRI pre-clinical contract research services business segment.

Our results of operations for the twelve-months ended December 31, 2007 include the operations of PharmaForm since the date of acquisition on January 25, 2007.

	2007	2006		
	Consolidated	Pharma Segment	Contract Research Segment	Consolidated
Revenues	12,632	2,810	23,156	\$25,966
Direct costs	5,897	-	14,088	14,088
Selling, general and administrative	14,016	8,597	4,706	13,303
Research and development	17,744	11,521	-	11,521
Stock-based compensation	997	856	30	886
Amortization expense	3,844	1,675	1,677	3,352
Interest on long-term debt	194	1,132	304	1,436
Foreign exchange	(1,249)	974	22	996
US listing charges	3,988			
Restructuring	-	3,859	-	3,859
Gain on disposal of LAB Research Inc.	-	(30,111)	-	(30,111)
Share in net income of a company subject to significant influence	-	(265)	-	(265)
Income taxes	(104)	4,488	2,612	7,100
Net earnings (loss)	\$ (32,695)	\$ 84	\$ (283)	\$ (199)

Revenues

We derive our revenues from licensing and co-development agreements and through providing contract research services such as drug formulation, drug development and limited run drug manufacturing for pharmaceutical and biotech companies. Revenues for the twelve-months ended December 31, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Co-development revenue	\$ 2,176	\$ 2,065	\$ 111
Contract services revenue	9,767	-	9,767
Interest revenue	689	745	(56)
Total revenue	\$ 12,632	\$ 2,810	\$ 9,822

Co-development revenue. We have entered into development and license agreements for our Fentanyl TAIFUN® inhaler. Under these agreements, we have granted development, marketing and distribution rights in specified world markets in return for co-development fees in the form of up-front payments, fees for development activities and payments tied to meeting development milestones. Also under the agreements, we will earn revenues for supplying the finished product, along with royalties on future sales, once commercialization begins. We currently have agreements for the South Korean, Chinese (excluding Hong Kong and Taiwan) and Japanese markets and in June 2007 signed a development and licensing agreement for Europe, the Middle East and Africa as discussed below. Co-development revenue increased to \$2.2 million for the twelve-months ended December 31, 2007 from \$2.1 million for the three-months ended December 31, 2006 reflecting the acceleration of our Fentanyl TAIFUN® inhaler development which completed Phase II studies during the third quarter of 2007.

In June 2007, we signed a licensing and development agreement with Janssen Pharmaceutica NV for Fentanyl TAIFUN. The licensing agreement covers the European Union, Eastern Europe, Russia, the Middle East and Africa. We will collaborate with Janssen Pharmaceutica to develop the product for the initial indication of break through cancer pain. We will manufacture and the Janssen Pharmaceutica companies will market and distribute the product. Under the terms of the agreement, we received a signing fee of \$10.7 million (€8.0 million) which has been deferred and is being recognized rateably over the estimated development period. In addition, we can receive up to an additional \$74.4 million (€55.0 million) for meeting development, regulatory, and commercial sales milestones and could receive royalty revenues and revenues from the sales of the product to Janssen Pharmaceutica. In December 2007, we extended the territory coverage of the initial license and development agreement with Janssen Pharmaceutica NV to include Canada for a signing fee of \$1.1 million. All other commercial and contractual conditions remain in effect.

Contract services revenue. Contract services revenue was \$9.8 million for the eleven-months ended December 31, 2007. This contract services revenue base was acquired in the acquisition of PharmaForm on January 27, 2007 therefore no such revenue was recorded in 2006. Revenue from service contracts with milestone delivery terms are recognized as milestones are reached. As such, contract services revenue can fluctuate between quarters.

Interest revenue. Interest revenue relates to interest earned on invested cash balances. The decrease in interest revenue is due to a decline in invested cash balances.

Expenses

Direct costs. Direct costs for the eleven-months ended December 31, 2007 related to the costs associated with providing contract services and include the cost of raw materials, direct and indirect labor, supplies and related equipment and facility overhead. These contract services are associated with activities acquired in the acquisition of PharmaForm on January 27, 2007; therefore no such expense was recorded in 2006.

Selling, general and administrative (SG&A). SG&A expenses consist of salary and benefits for the executive, accounting, administrative and business development personnel, professional fees and other corporate expenses. SG&A expense for the twelve-months ended December 31, 2007 increased to \$14.0 million from \$8.6 million. SG&A increased as a result of the acquisition of PharmaForm and additional salary and overhead, associated with supporting the expansion of our development operations. These costs were offset, in-part, by reductions in SG&A associated with the down-sizing of our Finnish operations which we completed late in the third quarter.

Research and Development (R&D). R&D expenses consists primarily of third-party clinical trial providers, salary and benefits for scientists and technicians, testing material, consultants and related overhead. R&D expense for the twelve-months ended December 31, 2007 increased to \$17.7 million from \$11.5 million. The increase in R&D expenses relates to increased third-party pre-clinical and clinical trial provider fees, salaries and benefits, material and overhead primarily associated with the development and advancement of our Fentanyl TAIFUN® product which completed Phase II trial programs during the third quarter of 2007. In addition, research and development expense also included costs associated with the development of our other products including GHRH which completed pilot Phase II trials and CGRP which is currently in Phase IIb studies.

Stock-based compensation. Stock-based compensation expense relates to stock options granted to employees. Employee stock options are accounted for using the fair value method. Under this method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period. Stock-based compensation for the twelve-months ended December 31, 2007 increased to \$1.0 million from \$0.9 million. The increase is due to the expense associated with the approximately 0.3 million employee stock options granted in early 2007.

Amortization expense. Amortization expense includes amortization of property and equipment as well as intangible assets. Amortization expense increased to \$3.8 million for the twelve-months ended December 31, 2007 from \$1.7 million for the twelve-months ended December 31, 2006. The increase in amortization expense relates to the January 2007 acquisition of PharmaForm, which resulted in \$8 million in intangible assets which are being amortized over a period of between three and five years and \$2.8 million in property and equipment which are being amortized over a period of between two and ten years.

Interest expense. Long-term interest expense of \$1.1 million for the twelve-months ended December 31, 2006 included \$0.8 million of interest and losses on the early settlement of a Laurus convertible debenture. By August 3, 2006, this debenture had been fully converted into 659,778 common shares of the Company resulting in lower interest expense in 2007.

Foreign Exchange Gain. Although our functional currency is the US dollar, a significant portion of our assets and liabilities are in Canadian dollars and Euros. The increase in the foreign exchange gains over the previous year reflected the strengthening of the Euro and Canadian dollar to the US dollar.

US listing charges. During the fourth quarter of 2007, \$4.0 million of deferred corporate transaction costs associated with a proposed share listing and financing in the US were expensed due to unfavorable market conditions.

QUARTERLY RESULTS

<u>Quarter</u>	<u>Revenues</u>	<u>Net Income (loss)</u>	<u>Net Income (Loss)</u>	
			<u>Basic</u>	<u>Diluted</u>
Quarter ended December 31, 2007	4,705	(8,882)	(0.75)	(0.75)
Quarter ended September, 2007	3,144	(8,598)	(0.73)	(0.73)
Quarter ended June 30, 2007	3,409	(7,108)	(0.60)	(0.60)
Quarter ended March 31, 2007	1,374	(8,107)	(0.70)	(0.70)
Quarter ended December 31, 2006	1,296	(743)	(0.07)	(0.07)
Quarter ended September, 2006	4,323	9,715	0.93	0.93
Quarter ended June 30, 2006	10,632	(4,806)	(0.47)	(0.47)
Quarter ended March 31, 2006	9,715	(4,365)	(0.44)	(0.44)

The quarterly results include the results of LRI to the date of the IPO, August 3, 2006. The Company ceased consolidating the results of operations of LRI in the third quarter of 2006, which accounts for the reduction in revenues in this period and the fourth quarter. The Company also recorded gains on disposal of its interest in LRI in both the third and fourth quarters of 2006.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Pharma segment's cash requirements were provided by the cash flow generated by the Contract Research segment and by the capital raised through the issuance of shares and/or debt. From January 1, 2004 to August 3, 2006 the Contract Research segment generated approximately \$16 million in cash flow from operations. Cash and cash equivalent balances at December 31, 2007 were \$6.7 million compared with \$35.3 million for the Pharma segment as of December 31, 2006. On March 27, 2008, we concluded a public offering for aggregate proceeds of Cdn \$10.4 million.

Akela has and continues to incur significant net losses. In October 2007, we filed a Registration Statement on Form F-1 (the "Registration Statement") with the U.S. Securities and Exchange Commission ("SEC") with the intention of effecting an initial public offering of Common Shares in the United States. Due to unfavorable market conditions, we determined that we were unable to proceed with the offering at that time. On January 17, 2008, we requested a withdrawal of the Registration Statement, together with all exhibits thereto, from the SEC. The Registration Statement had not become effective when we requested its withdrawal from the SEC and we did not sell any securities by means of the preliminary prospectus that formed a part of the Registration Statement. On March 27, 2008, we concluded a public offering of 8,625,000 units, each unit consisting of one common share listed on the TSX and one-half of one common share purchase warrant, for aggregate proceeds of Cdn \$10,350,000.

Due to these delays in funding, we have also significantly reduced our expenses and curtailed certain operations until additional funding has been secured. If additional funding is not obtained, we will likely curtail much of our development efforts and reduce our development and clinical operation cost structure through staff reductions and clinical facilities shutdowns.

Net cash flows for the years ended December 31, are summarized as follows:

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Cash used in operating activity	\$(14,930)	\$(16,367)	\$ 1,437
Cash used in financing activities	(2,416)	(197)	(2,219)
Cash provided by (used in) investing activities	(11,745)	38,433	(50,178)
Net (decrease) increase in cash	<u>\$(29,091)</u>	<u>\$ 21,869</u>	<u>\$(50,960)</u>

Operating Activity

Net cash used in operating activities decreased to \$14.9 million for the year ended December 31, 2007 compared to \$16.4 million for the same period in 2006. This decline in operating cash outflows is primarily due to \$10.7 million in signing fees received from Janssen Pharmaceutica for a licensing and development agreement signed in June 2007, which offset our operation cash burn as well as expenses associated with the downsizing of our Finnish subsidiary.

Financing Activity

Net cash used in financing activities for the year ended December 31, 2007 and 2006 was \$2.4 million and \$0.2 million, respectively. Finance activity during 2007 included the replacement of \$1.2 million of debt acquired in the PharmaForm acquisition with new debt as well as the payments under existing debt facilities. Our new long-term debt bears interest at 8.75% and is due in monthly installments over the next 5 years. Under the terms of the debt agreement, we are required to maintain \$0.6 million in a restricted certificate of deposit account. The debt is secured by a first lien on the accounts receivable and property and equipment of PharmaForm. Finance activity also reflects \$1.5 million of long-term debt associated with our Finnish subsidiary which was repaid in March and October of 2007. Financing activity in 2006 related primarily to the payment of outstanding debt, offset in part by proceeds from the issuance of shares and long-term debt.

Investing Activity

Net cash used in investing activities for the year ended December 31, 2007 was \$11.7 million versus cash provided by investing activities of \$38.4 million for the same respective period in 2006. Investing activities in 2007 principally related to the January 25, 2007 acquisition of PharmaForm, an Austin, Texas based specialty pharmaceutical company. Under the terms of the acquisition, we paid \$17.1 million, including cash and transaction costs totaling \$8.6 million (excluding net cash acquired of \$0.4 million) and shares valued at \$4.4 million and shares to be issued with an estimated value of approximately \$4.1 million. The sellers will be eligible for additional amounts payable in shares upon PharmaForm's completion of certain milestones. We are currently transferring all of our product development activities and most of our administrative activities to Austin, Texas to leverage the assets acquired. Investing activity in 2007 also included \$2.8 million in property and equipment purchases, primarily related to product development. Investing activity in 2006 reflects the disposition of LAB Research, which generated proceeds of approximately \$50.2 million, partially offset by the purchase of property and equipment and other assets.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The aggregate maturities of the contractual obligations are as follows:

	2008	2009	2010	2011	2012+	Total
Operating leases	\$ 723	602	44	-	-	\$ 1,369
Capital leases *	190	186	85	-	-	461
Service contracts	1,043	1,004	856	560	47	3,510
Clinical studies	830	-	-	-	-	830
Long-term debt *	575	445	445	445	4,969	6,879
	\$ 3,361	2,237	1,430	1,005	5,016	\$ 13,049

* Long-term debt and capital leases include principal and related interest.

- (a) We are party to an exclusive world-wide master license agreement whereby we were granted licenses to further develop and exploit commercial applications to be derived from a specific invention bearing a United States patent serial number. Under the license agreement, the Company undertakes to pay a royalty of 1.5% to 5% of specified sales, with a minimum annual amount of \$10. This license agreement will expire when the last of the patent rights expire. To date, only the minimum annual payment has been made.
- (b) We are required to pay Auxilium Pharmaceutical (“Auxilium”) 75% of any sublicense fees received by us from certain products jointly developed by the Company and Auxilium. To date, we have not received any such sublicense fees. In the event that certain license agreements with certain parties are terminated during the term of our agreement with Auxilium, the Company shall pay Auxilium one-half of all direct expenses and costs Auxilium has incurred related to the research and development of the compounds, technology or products pursued under the agreement which exceed the cumulative gross profit earned by Auxilium as of the date of termination. As of December 31, 2007, the minimum contingency associated with this agreement is \$1.6 million, representing one-half of amounts received by the Company from Auxilium, and is subject to upward adjustment for any additional amounts incurred by Auxilium on this project. No liability has been recorded for this contingency as of December 31, 2007.
- (c) Our Finnish subsidiary has received certain low interest loans and subsidies from a Finnish governmental agency. Following our decision to transfer certain activities from Finland to our facilities in Austin, Texas, we recently have been notified that this agency is reviewing loans and subsidies previously granted to the Company totalling €3,150 and €956, respectively. On November 26, 2007, the governmental agency issued a resolution to claim back with interest the subsidies. Further, the agency resolved not to attempt to collect the loans prematurely provided the company fulfill certain requirements which have yet to be stated. The Company has filed a claim for rectification of the resolution. Discussions with the agency are ongoing and we cannot, at this time, determine if the risk of loss is probable or what amount, if any would be payable. The Company believes that it has met all of the funding requirements and that the amounts in question are not due back to the Governmental Agency. Accordingly, all loans received from the Finnish governmental agency continue to be presented as long-term debt in these financial statements in accordance with the original terms of the agreement and no additional provision has been made in these financial statements with respect to this matter.
- (d) We have entered into four-year employment agreements with each of the three remaining members of PharmaForm (hereafter, the “Members”) in which these Members agreed to perform specific services for the Company as a full-time employee and for which they are to be paid an aggregate base salary of \$530. The base salaries can be adjusted upward for bonuses or commissions and provide for car

allowances. The agreements have initial terms of four-years, after which they may be renewed for additional one-year periods. In the event the Members employment is terminated without cause by the Company or for “Good Reason”, as defined in the agreements, the Members are entitled to continuation of their base salary, without modification, for the remainder of the initial or renewal term, whichever is applicable, cash payment for any vacation or leave accrued through the date of termination, and vesting and exercisability of any unvested stock grants or options granted subsequent to commencement of the employment agreement.

RELATED PARTY TRANSACTIONS

During 2007 and 2006, we incurred legal and tax consulting fees totalling \$387 and \$370 for professional services provided by two firms associated with the Board of Directors.

During 2007 and 2006, we also incurred \$212 and \$213 in expenses for IT consulting services provided by a firm owned by the Chief Executive Officer (CEO). In addition, during 2007 and 2006, we incurred expenses of \$488 and \$2,645, respectively, for management services provided by PRI International Consulting Inc., a company directly controlled by the CEO.

In 2007, we repaid \$1.5 million of long-term debt payable to non-controlling shareholders. During 2007 and 2006, we incurred interest expense of \$65 and \$112, respectively, associated with this debt. As a tenant under a facilities lease held by one of these non-controlling shareholders, we also incurred rent expense of \$2,051 and \$880 during the years ended December 31, 2007 and 2006.

During 2007, we incurred expenses totaling \$705 for consulting services paid to three current shareholders and the former principal owners of PharmaForm. One of these shareholders is also a member the board of directors.

During the corporate reorganization and disposal of LAB Reasearch Inc. (from August 3 to November 9, 2006), we purchased \$362 of inhalation toxicology services from LRI.

These transactions are measured at the exchange amount of consideration established and agreed to by the related parties.

SUBSEQUENT EVENTS

On February 4, 2008, we received notice from the United States Food and Drug Administration (“FDA”) that, due to Good Laboratory Practice (“GLP”) deviations, the six month inhalation toxicology studies of Fentanyl TAIFUN® dry powder inhaler performed for us on dogs and rats by a CRO were deemed invalid. No toxicological reasons were cited. We intend to repeat the inhalation toxicology studies in their entirety in the United States using a different CRO in 2008. The cost of the repeated studies is estimated to be \$4.5 million. We are seeking to recover the cost of the repeated studies from the CRO that conducted the invalidated studies but there is no assurance that this effort will be successful. We will be concurrently conducting our Phase III clinical trials outside the United States, primarily in Europe and Asia.

On March 27, 2008, we concluded a public offering of 8,625,000 units, each unit consisting of one common share and one-half of one common share purchase warrant, for aggregate proceeds of Cdn \$10,350,000. Each whole warrant is exercisable to purchase one common share at a price of Cdn \$1.50 per share and expires three years from the closing date subject to our right to accelerate the expiry date of the warrants in certain events. Expenses in connection with the offering are expected to be approximately Cdn \$1.0 million. In addition we granted compensation options to the underwriters to purchase 525,000 common shares at Cdn \$1.20 per share that expire three years from the closing date. We have also granted the underwriters an option to purchase 603,750 common shares at a price of Cdn \$1.20 per share that expires two years from the closing date.

OUTSTANDING SHARE DATA

At February 29, 2008, the number of common shares issued and outstanding was 11,768,294. In addition, the Company had 1,126,393 outstanding options and one warrant to purchase 252,898 common shares at a price of \$7.70 (US \$7.63) per share at any time prior to April 22, 2010, and 1,222,284 common shares issuable in connection with the settlement of a contingent consideration for the PharmaForm acquisition.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure. The Company's Chief Executive Officer and its Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures. Based on an evaluation of the Company's disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of December 31, 2007.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are responsible for designing internal control over financial reporting or causing it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. The CEO and CFO assessed the design of the Company's internal control over financial reporting as at December 31, 2007 and deemed them to be effective.

OUTLOOK

We are engaged in a business characterized by extensive research efforts, rapid technology developments and intense competition. Our competitors include large and small pharmaceutical and biotechnology companies, universities and research institutions. All of these competitors currently engage in, have engaged in or may engage in the future in the development, manufacturing, marketing and commercialization of new pharmaceuticals and existing pharmaceuticals, some of which may compete with our product candidates. We expect that successful competition will depend, among other things, on product efficacy, safety, reliability, availability, timing and scope of regulatory approval and price.

A large part of our business is based upon the reformulation of existing drugs. As a result, our product candidates will face competition from generic and branded formulations of the existing drugs we reformulate. Our drug delivery technologies will compete with existing drug delivery technologies, as well as new drug delivery technologies that may be developed or commercialized in the future. Any of these drugs and drug delivery technologies may receive government approval or gain market acceptance more rapidly than our product candidates, may offer therapeutic or cost advantages over our product candidates or may cure our targeted diseases or their underlying causes completely. As a result, our product candidates may become non-competitive or obsolete.

We believe that our ability to successfully compete will depend on, among other things:

- the efficacy, safety and reliability of our product candidates;
- the timing and scope of regulatory approval;
- the speed at which we develop product candidates;
- our ability to manufacture and sell commercial quantities of a product to the market
- product acceptance by physicians and other health care providers;
- the quality and breadth of our technology;
- the skills of our employees and our ability to recruit and retain skilled employees; and
- the protection of our intellectual property.

Break-through Cancer Pain

The current market leader for break-through cancer pain treatment is Cephalon Inc., the approved manufacturer of Fentora and Actiq. We understand that YM Biosciences Inc., Aradigm Corporation and Alexza Pharmaceuticals Inc. each have an inhaled formulation of fentanyl in clinical trials. In addition, we understand that Biodelivery Sciences has a dissolvable formulation of fentanyl using a buccal tablet which is in late stage clinical trials and that Insys Therapeutics Inc. is developing a nasal spray formulation of fentanyl which is in early clinical trials.

Of the three known competing inhaled fentanyl projects, we believe our Fentanyl TAIFUN® product candidate is currently in a lead position, and we anticipate it will become the first approved inhaled fentanyl product. In addition to inhaled fentanyl, several new oral and intranasal products are in development. These products are expected to increase substantially the market for fentanyl in the treatment of break-through cancer pain. We do not believe that any of them are able to provide for onset of pain relief as fast as an inhaled formulation.

We believe that the clinical performance of Fentanyl TAIFUN® will enable us to capture a significant share of the overall break-through cancer pain market. In particular, the excellent dosage success and very fast onset of action obtained with Fentanyl TAIFUN® compare favorably with data published from trials on transmucosal fentanyl preparations. In these transmucosal trials, higher doses have been required to achieve the desired results. Even with such higher doses of medication, the proportion of patients that were successfully titrated was lower, and onset of efficacy much slower. This apparent opioid sparing effect of Fentanyl TAIFUN®, with a narrow range of titration, is most likely due to its unique pharmacokinetic profile, which combines an essentially immediate absorption of the drug with a prolonged and relatively steady concentration for the duration of a typical break-through pain attack.

Abuse Deterrence

It is our understanding that several companies are currently developing abuse deterrent systems using the combination of opioid and opioid antagonist/irritant, including Alpharma Inc., Acura Pharmaceuticals Inc., Purdue Pharma L.P. and Elite Pharmaceuticals Inc.

We also understand that companies such as Egalet A/S, Pain Therapeutics Inc., Durect Corporation, TheraQuest Biosciences, LLC and Collegium Pharmaceutical Inc. are developing products using non-crushable or chemical resistant technologies.

Growth Hormone

Based upon information publicly available, we understand that Theratechnologies Inc. is currently in clinical trials with TH9507 (natural 44 amino acid sequence of human GRF with a hexenoyl moiety) in HIV-associated lipodystrophy. It is administered via intravenous injection and increases endogenous secretion of GH from the pituitary gland in a pulsatile fashion. We anticipate that the effective therapeutic dose of our GHRH agonists may have a longer duration of action than TH9507. This should result in improved convenience and greater cost effectiveness for our GHRH product candidate.

We understand that other companies have GH compounds in development, including Conjuchem Inc., Aeterna Zentaris Inc., Sapphire Therapeutics Inc. and QLT Inc.

Asthma

We understand that many established companies' products currently command large market shares in the mild to moderate asthma market, including Merck & Co., Inc.'s Singulair®, GlaxoSmithKline plc's Advair® and inhaled corticosteroid products. These therapies are also used in combination with, or as add-on therapies to, oral and injectable steroid treatments in the severe asthma market. One product, Xolair®, developed jointly by Novartis AG, Genentech, Inc. and Tanox, Inc., was approved in 2004 for severe allergic asthma. We may also face competition from pharmaceutical companies seeking to develop new drugs for the asthma market. For example, in July 2006, AstraZeneca Co, LLC announced the approval of Symbicort®, a twice-daily asthma therapy combining budesonide,

an inhaled corticosteroid, and formoterol, a beta2-agonist, that is expected to compete in the moderate and severe asthma markets.

Inhalation Technology

Our most significant competitors as technology providers are pulmonary drug delivery companies. Skyepharma Plc and Vectura Group Plc are both developing multiple dose dry-powder inhalers. In addition, Ventaira Pharmaceuticals, Inc. is emerging into the field with a liquid based inhaler using an electrical aerosolization system.

In the United States, the key competitors are Nektar Therapeutics, Aradigm Corporation, Alkermes Inc. and Alexza Pharmaceuticals Inc. The most significant of these, Nektar, is developing several products that apply its proprietary Enhance® multiple-unit dose inhaler that is targeted at the delivery of protein compounds.

Aradigm Corporation has a sophisticated liquid based multiple unit dose inhaler, which is being developed for the administration of insulin via the lungs. Alkermes is using its AIR® technology to develop inhaled insulin. Alexza's most advanced program is a treatment for migraine using its Staccato device, which is currently in clinical trials.

Transmucosal Delivery

We understand that many companies, including BioDelivery Sciences International Inc., Biovail Corporation and Cephalon Inc., are developing transmucosal formulations, as transmucosal drug delivery is potentially very convenient to use and versatile in terms of application.

CRITICAL ACCOUNTING ESTIMATES

Goodwill and Other Intangibles

We account for business acquisitions using the purchase method. Accordingly, the purchase price of a business acquisition is allocated to its identifiable net assets, including identifiable intangible assets, on the basis of estimated fair values as of the date of purchase, with any excess being assigned to goodwill. We estimate the fair value of assets and liabilities acquired at the date of acquisition using a projected discounted cash flow method and other valuation methods. We make a number of significant estimates when calculating fair value using a projected discounted cash flow method. These estimates include estimating projected cash flows, the number of years used, the discounted rate and others. We believe that our estimates and the valuation methods are reasonable. They are consistent with our inherent planning and reflect our best estimates, but they have inherent uncertainties that management may not be able to control.

Goodwill is not amortized but rather evaluated under an impairment approach. Other intangible assets with finite lives continue to be amortized over their estimated useful lives. The amounts recorded as intangible assets at the date of acquisition represent the estimated fair value of these assets based on estimate future cash flows discounted appropriate discount rates. In addition, in our assessment of impairment, we are required to determine the fair value of the businesses from which the goodwill and intangibles originated. For intangibles with finite lives, we make estimates of future cash flows to be generated from the related assets.

Impairment of long-lived assets

The Company tests long-lived assets or asset groups for future recoverability when events or changes in circumstances indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to: significant decreases in the market price of the asset; significant adverse changes in the business climate or legal factors; accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and current expectation that the asset will more likely than not be sold or disposed of significantly before the end of its estimated useful life. The Company's long-lived assets consist primarily of property and equipment and intangible assets.

Recoverability of a long-lived asset is assessed by comparing the carrying amount of the asset to the sum of the estimated undiscounted future cash flows expected from its use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount of a long-lived asset is not recoverable and the amount of such impairment loss is determined as the excess of the carrying amount over the asset's fair value. Fair value is the estimated value at which the asset could be bought or sold in a transaction between willing parties. The fair value against which the asset is measured may be established based on comparable information or transactions, or any other acceptable method of assessment.

Income taxes

The Company uses the tax liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are determined based on the differences between the carrying value and the tax bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect in the periods in which the deferred income tax assets or liabilities are expected to reverse. The Company establishes a valuation allowance against deferred income tax assets if, based on available information, it is more likely than not that some or all of the deferred income tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The Company has determined that a 100% tax valuation allowance is necessary at December 31, 2007. In the event the Company was to determine that it would be able to realize its tax asset, an adjustment to the tax asset would increase income in the period in which such determination is made.

Revenue recognition

Pharma's revenues consist of pharmaceutical testing services performed on behalf of third parties. Revenues are recognized at the time research activities are performed under the agreement. Upfront and milestone payments which require the Company's ongoing involvement are deferred and amortized into income over the estimated period of service. Upfront payments are nonrefundable. When a milestone is achieved, a portion of the milestone revenue equal to the amount of progress towards completion of the total contract is recognized. The remaining portion of the milestone is amortized into future periods as additional progress towards completion is achieved. To measure performance, the Company compares the direct labor costs incurred to estimated total direct labor contract costs through completion. The Company believes direct labor cost reliably tracks the progress toward completion and is the best indicator of the performance under the contract obligations because our service is people intensive. Therefore, such costs directly correspond to the level of effort necessary to perform the service. The estimated total direct labor costs to complete a project are reviewed and revised periodically throughout the lives of the contracts, with adjustments to revenue resulting from such revisions being recorded on a cumulative basis in the period in which the revisions are first identified. Fees for development funding, sales and royalties are recognized when the service is rendered or the product delivered, the amount is determinable and collectibility is reasonably assured. Deferred revenues represents deferred license fees and payments received in advance of services being performed, milestones being reached or from final deliverables being provided.

LRI's revenues are included up until August 3, 2006, consisting of services rendered to customers, and are recognized as the services are performed or delivered by the Company. Revenue is recorded by determining the status of work performed per contract in relation to the total services to be provided. Work in progress represents amounts receivable for services rendered, but which only become billable in accordance with contractual payment terms.

Revenues that include multiple elements are considered to be revenue arrangements with multiple deliverables. Under these arrangements, the identification of separate units of accounting is required and revenue is allocated among the separate units based on their relative fair values or using the residual method. Revenues for each unit of accounting are then recorded as described above.

Sales taxes collected from customers are presented on a net basis.

PharmaForm's revenues are included from the date of acquisition, January 25, 2007. PharmaForm revenue for contract services is recognized as work is performed, and amounts are earned. The timing of cash received from our contract services agreements can differ from when revenue is recognized. The Company considers amounts to be earned once evidence of an arrangement has been obtained, services are delivered, fees are fixed or determinable, and collectability is reasonably assured. For contracts with fees based on time and materials, revenue is recognized over the period of performance.

For fixed price contracts, depending on the specific contractual provisions and the nature of the deliverables, revenue may be recognized as milestones are achieved or when final deliverables have been provided. At times, our arrangements with customers involve multiple elements. The deliverables in each arrangement are evaluated at contract inception to determine whether they represent separate units of accounting. The total fee for the arrangement is allocated to each unit of accounting based on its relative fair value, taking into consideration any performance, cancellation or termination provisions. Fair value for each element is generally established based on the sales price charged when the same or similar services are sold separately to customers. Revenue is recognized when revenue recognition criteria for each unit of accounting is met.

Research and development expenses

Research and development costs are expensed as incurred and include salaries, benefits and other operating costs such as outside services, supplies and allocated overhead costs. The Company performs research and development for its proprietary products and technology development and for others pursuant to collaboration agreements. For proprietary products and internal technology development programs, the Company invests its own funds without reimbursement from a third party. Costs associated with the treatment phase of clinical trials are accrued based on the total estimated cost of the clinical trials and are expensed ratably based on patient enrollment in the trials. Costs associated with the start-up and reporting phases of the clinical trials are expensed as incurred.

Collaboration agreements typically include the development and licensing of the Company's technology. Under these agreements, the Company may be reimbursed for development costs, entitled to milestone payments when and if certain development or regulatory milestones are achieved, compensated for the manufacture and supply of clinical and commercial product and entitled to royalties on sales of commercial product. All of the Company's collaboration agreements are generally cancelable by the partner without significant financial penalty.

Government assistance

Amounts received resulting from government assistance programs, including grants and investment tax credits for research and development, are reflected as a reduction of the cost of the asset or expense to which they relate at the time the eligible expenditures are incurred. Tax credits are recorded in the accounts when reasonable assurance exists that they will be realized.

Foreign currency translation

Through December 31, 2006, the functional currency of the Company is the Canadian dollar. The reporting currency in these financial statements is the U.S. dollar and accordingly, the consolidated financial statements have been translated into the reporting currency (the U.S. dollar) using the current rate method. Under this method, the consolidated financial statements are converted as follows: assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the average exchange rate for the reporting period. Elements of stockholders' equity are translated and accumulated at the rates of exchange on the respective transaction dates or at cumulative average exchange rates. All adjustments resulting from the translation of the financial statements into the reporting currency are included in accumulated other comprehensive income.

Effective January 1, 2007, the Company adopted the US dollar as its functional and reporting currency.

Transactions denominated in currencies other than the functional currency are measured and recorded in the functional currency using the exchange rate in effect at the date of the transaction or the average rate for the period in the case of recurring revenue and expense transactions. Monetary assets and liabilities are revalued into the functional currency at each balance sheet date using the exchange rate in effect at that date, with any resulting exchange gains or losses being credited or charged to the consolidated statements of operations. Non-monetary

assets and liabilities are measured and recorded in the functional currency using the exchange rate in effect at the date of the transaction and are not revalued for subsequent changes in exchange rates.

Stock-based compensation

We account for stock-based compensation using the fair value method. This statement requires that all stock-based compensation costs be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This compensation cost is recognized as an expense ratably over the estimated service period of the respective grantee.

The Company uses the Black-Scholes option pricing model to calculate stock option values, which requires certain assumptions, including the future stock price volatility and expected time to exercise. Changes to any of these assumptions, or the use of a different option pricing model could produce different fair values for stock-based compensation, which could have a material impact on the Company's earnings.

RECENT ACCOUNTING PRONOUNCEMENTS

(a) New Accounting Pronouncements Adopted in 2007

Effective with the commencement of its 2007 fiscal year, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. Sections 3855, 3861 and 3865 provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. Handbook section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period and requires the Company to present separately equity components and changes in equity arising from (i) net earnings; (ii) other comprehensive income; (iii) other changes in retained earnings; (iv) changes in contributed surplus and (v) changes in capital. A new consolidated statement of changes in shareholders' equity is presented in these consolidated financial statements.

Handbook Section 1530 also establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles. A new financial statement has been presented in relation to the new standards.

Under these new standards, all financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are measured either at fair market value with the exception of loans and receivables, investments held-to-maturity and other financial liabilities, which are measured at amortized cost. Subsequent measurement and recognition of changes in fair value of financial instruments depend on their initial classification. Held for trading financial investments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet.

The standards also require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. The Company chose to review all contracts in place on January 1, 2007 that were entered into

after January 1, 2003, for any embedded derivatives required to be accounted for at fair value from the base contract.

As a result of these standards, the Company has classified cash equivalents and restricted cash as available for sale. The Company has classified accounts receivable as loans and receivables and accounts payable and accrued liabilities and long-term debt as other financial liabilities. The adoption of these standards has no impact on the financial statements of operations and comprehensive loss for the fiscal year ended December 31, 2007.

(b) Future Accounting Pronouncements

In December 2006, the CICA issued Section 1535, *Capital Disclosures*. This Section established standards for disclosing information about an entity's capital and how it is managed. For the Company, this Section is effective for fiscal periods beginning on or after January 1, 2008. The new standard relates to disclosure only and will not impact the Company's financial results.

In December 2006, the CICA issued Section 3862, *Financial Instruments – Disclosure*, and Section 3863, *Financial Statements - Presentation*. These Sections are effective for fiscal periods beginning on or after October 1, 2007. For the Company, these sections replace existing Section 3861, *Financial Instruments – Disclosure and Presentation*. Disclosure standards are enhanced and expanded to complement the changes in accounting policy adopted in accordance with Section 3855, *Financial Instruments – Recognitions and Measurement*. These new standards, which are effective January 1, 2008 for the Company, relate to disclosure and presentation only and will not impact our financial results.

In January 2008, the CICA issued Section 3064, *Intangible Assets*, which will replace Section 3062, *Goodwill and Other Intangible Assets*. The standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition as well as clarifying the application of the concept of matching revenues and expenses, whether these assets are separately acquired or internally developed. This standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company is currently evaluating the effects of adopting this standard.

In 2005 the Accounting Standards Board of Canada (AcSB) announced that accounting standards in Canada are to converge with IFRS. In May 2007, the CICA published an updated version of its "Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP." This plan includes an outline of the key decisions that the CICA will need to make as it implements the Strategic Plan for publicly accountability enterprises that will converge Canadian generally accepted accounting standards with IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed. The CICA has confirmed the changeover date from current Canadian GAAP to IFRS to be January 1, 2011.

RISKS AND UNCERTAINTIES

Risks Related to Financing Our Business

We have incurred operating losses and anticipate that we will continue to incur losses for the foreseeable future. We have never had any products available for commercial sale and we may never achieve or sustain profitability.

We are an integrated product development company and our proposed products are currently in research and development. We are not profitable and have incurred operating losses. We have never had any products available for commercial sale and we have not generated any revenue from product sales. We do not anticipate that we will generate revenues from the sale of products for the foreseeable future, but we continue to incur expenses related to our operations. Our consolidated net loss for the years ended December 31, 2007 and 2006 was \$32.7 million and \$0.2 million, respectively. For the year ended December 31, 2006, results include a gain on the disposal of LRI; our net loss excluding the gain was \$30.3 million. As of December 31, 2007, we had an accumulated deficit of U.S.\$59.4 million. We expect to continue to incur losses for the foreseeable future, and we expect these losses to

persist as we continue our research activities and conduct development of, and seek regulatory approvals for, our product candidates, and prepare for and begin to commercialize any approved products. We may never become profitable. Even if we achieve profitability in the future, we may not be able to sustain profitability. Any failure to successfully develop and obtain regulatory approval for product candidates that are currently under development would have a material adverse effect on our business, financial condition and results of operations.

We will have additional future capital needs and there are uncertainties as to our ability to raise additional funding. If we fail to obtain additional financing, we may be unable to complete the development and commercialization of our product candidates or continue our clinical trials and other research and development programs.

Our operations have consumed substantial amounts of cash since inception. We expect to continue to spend substantial amounts to:

- initiate and complete the clinical development of our other product candidates;
- develop, license or acquire additional product candidates;
- launch and commercialize any product candidates for which we receive regulatory approval; and
- continue our research and development programs.

Based upon our existing capital resources and funds received from co-development and licensing agreements substantial additional funds nonetheless will be required over the next five years to develop our current product and platform portfolio to the point where these products and platforms can be either commercialized or out-licensed. These costs will be financed using our current working capital, by funds received through co-development and licensing arrangements and through the issuance of shares and/or debt as required. In addition, our future cash requirements may vary materially from those now expected. For example, our future capital requirements may increase if we:

- experience scientific progress sooner than expected in our discovery, research and development projects, if we expand the magnitude and scope of these activities, or if we modify our focus as a result of our discoveries;
- experience setbacks in our progress with preclinical studies and clinical trials are delayed;
- experience delays or unexpected increased costs in connection with obtaining regulatory approvals;
- experience unexpected or increased costs relating to preparing, filing, prosecuting, maintaining, defending and enforcing patent claims; or
- elect to develop, acquire or license new technologies and products.

If sufficient capital is not available, we may be required to delay, reduce the scope of or eliminate one or more of our clinical trials and/or research and/or development projects, any of which could have a material adverse effect on our business, financial condition, prospects or results of operations. We may also seek collaborators for our product candidates at an earlier stage than otherwise would be desirable and on terms that are less favorable than might otherwise be available. We may be required to relinquish or license on unfavorable terms our rights to technologies or product candidates that we otherwise would seek to develop or commercialize ourselves.

A Finnish governmental agency is reviewing the loans and grants previously granted to our Finnish subsidiary and has made a demand for repayment of the grants.

Our Finnish subsidiary received certain low interest loans and grants from a Finnish governmental agency. In the summer of 2007, following our decision to down-size the Finnish operations, we were notified that this agency was reviewing loans and grants previously made to us totaling 3,150,000 euros and 955,664 euros,

respectively. The agency has not at this time attempted to call the loans but has made a demand for repayment of the grants, together with interest. Discussions with the agency are ongoing and we cannot determine if such review will lead to repayment of all or a portion of the grants we received. We have made no provision in our financial statements for the repayment of such amounts and, if any such payment were required, additional funding would be necessary. There is no assurance that any such additional funding would be available on terms that we consider reasonable or at all. In the absence of such financing, we would likely have to scale back the development of our product candidates.

If we raise additional financing, the terms of such transactions will cause dilution to existing shareholders and/or may contain terms that are not favorable to us or existing shareholders.

We may seek to raise additional financing through private placements or public offerings of our equity or debt securities. We cannot be certain that additional funding will be available on acceptable terms, or at all. To the extent that we raise additional funds by issuing equity securities, our shareholders may experience significant dilution. Any debt financing, if available, may involve restrictive covenants, such as limitations on our ability to incur additional indebtedness, limitations on our ability to acquire or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business.

Risks Related to Clinical Trials and Regulatory Approval

We have been highly dependent on the success of our lead product candidate, Fentanyl TAIFUN®, and we cannot give any assurance that it or any of our other product candidates will receive regulatory approval or be successfully commercialized.

We have invested a significant portion of our financial resources in the development of our lead product candidate, Fentanyl TAIFUN®. Although we have several other products under development, they are at an earlier stage of development.

We recently completed our Fentanyl TAIFUN® Phase IIb clinical trials. In order to market Fentanyl TAIFUN®, we will have to conduct additional clinical trials, including a Phase III clinical trial, to demonstrate safety and efficacy. The FDA recently deemed invalid the inhalation toxicology studies on Fentanyl TAIFUN® dry powder inhaler performed for us on dogs and rats by a CRO due to GLP deviations. We intend to repeat the inhalation toxicology studies in their entirety in the United States using a different CRO in 2008. We are seeking to recover the cost of the repeated studies from the CRO that conducted the invalidated studies but there is no assurance that this effort will be successful. We will be concurrently conducting a Phase III clinical trial outside the United States, primarily in Europe and Asia.

Our other product candidates focusing on pain that utilize our abuse-deterrent EDACS™ technology are currently in preclinical development. Our other non-pain product candidates, a GHRH analog and a calcitonin composition, are also in Phase II clinical trials and are subject to the risk that Phase III clinical trials may be delayed, altered or not initiated, that regulatory approval may never be achieved and that these products, if commercialized, may not be successful. Our clinical development programs for each of these three product candidates may fail to receive regulatory approval if we are not able to demonstrate that the relevant product candidate is safe and effective in clinical trials, and consequently we may fail to obtain necessary approvals from the FDA, European Agency for the Evaluation of Medicinal Products (“**EMEA**”) or similar regulatory agencies in Canada and elsewhere.

The results of preclinical studies and previous clinical trials are not necessarily predictive of future results, and our current product candidates may not have favourable results in later testing or trials.

Preclinical tests and Phase I and Phase II clinical trials are primarily designed to test safety, to study pharmacokinetics and pharmacodynamics and to understand the side effects of products at various doses and schedules. Success in preclinical or animal studies and early clinical trials does not ensure that later large-scale efficacy trials will be successful and is not necessarily predictive of final results. Favourable results in early trials may not be repeated in later trials and positive interim results do not ensure success in final results.

The results of preclinical tests and clinical trials are frequently susceptible to:

- varying interpretations of results that may delay, limit or prevent regulatory approvals;
- negative or inconclusive results or adverse medical events that may cause the clinical trial to be delayed, repeated or terminated; or
- third-party actions that are outside of our control, including patients, investigators, contract research organizations (“**CRO**”), Institutional Review Boards (“**IRB**”) or ethics committees, Data Safety Monitoring Boards (“**DSMB**”) and government regulators.

Even after the completion of Phase III clinical trials, the FDA, EMEA or other regulatory authorities may disagree with our clinical trial design and our interpretation of data, and may require us to conduct additional clinical trials to demonstrate the efficacy of our product candidates.

Share prices for life sciences companies have declined significantly in instances where clinical results were not favorable, were perceived negatively or otherwise did not meet expectations. Unfavorable results or negative perceptions regarding the results of clinical trials for any of our product candidates could cause our share price to decline significantly and could lead to shareholder lawsuits, securities regulatory inquiries and government investigations.

Clinical trials for our product candidates are expensive and time-consuming, and their outcome is uncertain.

Before we can obtain regulatory approval for the commercial sale of any product candidate, we are required to complete extensive clinical trials to demonstrate the product’s safety and efficacy. Clinical trials are very expensive and difficult to design and implement. Notwithstanding any estimates we may make as to the timing of the commencement, continuation and completion of any of our clinical trials, there can be no guarantee that such trials will not be subject to significant delays relating to various causes, including:

- our inability to manufacture or obtain sufficient quantities of materials for use in clinical trials;
- delays arising from collaborative arrangements;
- delays in obtaining regulatory approvals to commence a study, or government intervention to suspend or terminate a study;
- delays, suspension, or termination of the clinical trials due to the independent ethics board responsible for overseeing the study to protect research subjects at a particular study site;
- delays in identifying and reaching agreement on acceptable terms with prospective clinical trial sites;
- difficulty recruiting and enrolling sufficient numbers of patients, which is affected by:
 - design of the protocol;
 - the size of the patient population;
 - eligibility criteria for the study in question;
 - perceived risks and benefits of the drug under study;
 - availability of competing therapies;
 - efforts to facilitate timely enrollment in clinical trials;
 - public reputation of the investigator(s) or study site(s);

- patient referral practices of physicians; and
- availability of clinical trial sites.
- uncertain dosing issues;
- inability or unwillingness of medical investigators to follow clinical protocols or drug control procedures;
- variability in the number and types of subjects available for each study and resulting difficulties in identifying and enrolling subjects who meet trial eligibility criteria;
- scheduling conflicts with participating clinicians and clinical institutions;
- difficulty in maintaining contact with subjects after treatment, resulting in incomplete data;
- unforeseen safety issues or side effects;
- lack of efficacy during the clinical trials;
- reliance on CROs to conduct clinical trials, which may not conduct those trials with good clinical or laboratory practices; and
- other regulatory delays.

For example, the FDA recently deemed invalid the inhalation toxicology studies on Fentanyl TAIFUN® dry powder inhaler performed for us on dogs and rats by a CRO due to GLP deviations. See “Subsequent Events”.

Our clinical trials may be suspended or terminated at any time by the FDA, EMEA or other regulatory authorities, the IRB or ethics committee overseeing the clinical trial at issue, any of our clinical trial sites with respect to that site or us. Any failure or significant delay in completing clinical trials for our product candidates could materially harm our financial results and the commercial prospects for our product candidates.

Our product candidates may cause undesirable and potentially serious side effects during clinical trials that could delay or prevent their regulatory approval or commercialization.

Undesirable side effects caused by any of our product candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in the denial of regulatory approval by the FDA, EMEA or other non-U.S. regulatory authorities for any or all targeted indications. This, in turn, could prevent us from commercializing our product candidates and generating revenues from their sale.

Any one or a combination of these events could prevent us from achieving or maintaining market acceptance of the affected product or could substantially increase the costs and expenses of commercializing the product, which in turn could delay or prevent us from generating significant revenues from the sale of the product.

Fentanyl TAIFUN® is a potent opioid analgesic that may cause potentially life-threatening respiratory depression if administered in high doses. This risk may be increased with a product that produces a very rapid and high concentration of fentanyl, such as Fentanyl TAIFUN®. For this reason, all patients that receive Fentanyl TAIFUN® treatment must be tolerant to opioids, and the administration is started from low doses and increased to higher doses only if the patient requires a higher dose to achieve analgesia and has no undesirable effects, such as respiratory depression. With adherence to these precautions, no respiratory depression has been observed in patients receiving Fentanyl TAIFUN®.

The FDA has indicated to us that we will need to submit a risk minimization action plan (“**RiskMAP**”) to address certain identified risks associated with the use of Fentanyl TAIFUN®. Generally speaking, a RiskMAP is a strategic safety program designed to achieve specific safety-related health outcomes or goals in minimizing known

risks of a product, while preserving its benefits. We expect that our RiskMAP will fully address the risks identified by the FDA and our risk minimization program.

If new therapies become broadly used, we may need to conduct clinical trials of our product candidates in combination with these new therapies to demonstrate the safety and efficacy of the combination. Additional trials will delay the development of our product candidates and increase our costs. The failure of our product candidates to work in combination with these new therapies would have an adverse effect on our business.

We will need to assess new therapies as they are developed to determine whether to conduct clinical trials of our product candidates in combination with them to demonstrate safety and efficacy of the combination. If we determine to conduct additional clinical trials of our product candidates in combination with these new therapies, the development of our product candidates will be delayed and our costs increased. If these clinical trials generate safety concerns or lack of efficacy, our business would be adversely affected.

If our product candidates become approved in combination with a specific therapy that is broadly used and that therapy becomes displaced by another product, the market for our product candidate may decrease.

We rely, in part, on third parties to conduct clinical trials and other studies for our product candidates and plan to rely on third parties to conduct future clinical trials and other studies. If these third parties do not successfully carry out their contractual duties or meet expected deadlines, we may be unable to obtain regulatory approval for or commercialize our product candidates.

To implement our product development strategies, we rely, in part, on third parties, such as CROs, medical institutions, clinical investigators and contract laboratories, to conduct the clinical trials of our product candidates. One CRO, Allied Research International, conducted our CGRP Phase IIa clinical trial; Encorium Oy, a Finnish CRO, conducted our GHRH pilot Phase II clinical trial; and two CROs, Hyperphar N.V. and Pharos GmbH, conducted our Fentanyl TAIFUN® Phase II clinical trial. In addition, we relied on LRI to conduct inhalation toxicology studies on Fentanyl TAIFUN®. The types of services provided by these CROs include the preparation of case report forms, site management and monitoring, bio-statistics, data management and final report preparation and can be replaced with a minimum of operational disruption. Although the services our CROs currently perform are commodity services that can be easily relocated, we may rely more substantially on third parties in the future.

Despite our utilization of third-party services to conduct our clinical trials, we are responsible for ensuring that each of our clinical trials is conducted in accordance with:

- our investigational plan and protocol; and
- regulations and standards for conducting, monitoring, recording and reporting the results of clinical trials.

Such regulations and standards, commonly referred to as Good Clinical Practices (“GCPs”) have been designed to ensure that the data and results of clinical trials are scientifically credible and accurate and that the clinical trial subjects are adequately informed of the potential risks of participating in clinical trials.

If the third parties conducting our clinical trials do not perform their contractual duties or obligations, do not meet expected deadlines or need to be replaced, or if the quality or accuracy of the clinical data they obtain is compromised due to the failure to adhere to GCPs or for any other reason, we may need to enter into new arrangements with alternative third parties and our clinical trials may be extended, delayed or terminated. For example, the FDA recently deemed invalid the inhalation toxicology studies on Fentanyl TAIFUN® dry powder inhaler performed for us on dogs and rats by a CRO due to GLP deviations. In addition, a failure by such third parties to perform their obligations in compliance with GCPs may cause our clinical trials to fail to meet regulatory requirements, which may require us to repeat our clinical trials, and may lead to investigations or enforcement actions by applicable government regulators against us or the third parties.

In the future, we may conduct our own clinical trials in certain countries through either targeted acquisitions of certain existing clinical operations or the establishment of new operations. There can be no assurance that we will pursue this strategy or that such strategy would mitigate against this risk.

Our drug development and formulation services business is regulated by numerous federal, state, and local governmental authorities in the United States and elsewhere subjecting us to compliance costs and risks of non-compliance.

Our operations in Austin, Texas provide pharmaceutical development and formulation services and pre-commercial manufacturing on a fee-for-service basis to third parties for their products. We expect that these capabilities, together with the intellectual property acquired by us in the PharmaForm acquisition, will allow us to accelerate our product development strategy, broaden our drug platform pipeline and provide for the eventual manufacture of our products within the United States. However, the manufacturing, distribution, processing, formulation, packaging, storage, and disposal functions in Austin are subject to numerous and complicated federal, state, and local governmental regulations in the United States including, but not limited to, GLPs, GCPs, and current Good Manufacturing Practices (“GMP”). We must maintain our facility’s U.S. Drug Enforcement Agency (“DEA”) and FDA registrations. Failure to do so would require new testing and compliance inspections. Compliance with all federal, state, and local requirements in the United States is difficult and expensive. Manufacturers and their facilities are subject to continual review and periodic inspections. Failure to comply could result in:

- penalties;
- suspension of manufacturing, and/or testing;
- costly changes to achieve compliance;
- loss of permits or licenses; or
- facility closure.

Each of the above-listed occurrences could have a material and adverse effect on our business, financial condition, and current operation, and could negatively affect our ability to service our third-party customers or meet contractual commitments, as well as significantly delay or prevent us from developing and commercializing our own product candidates.

If our third-party customers file complaints about our services or our facilities, we could be subject to lawsuits and the DEA or FDA may impose restrictions or limitations on our activities or potentially close the facility. We are subject to ongoing periodic unannounced inspection by the FDA, DEA and non-U.S. regulatory authorities to ensure strict compliance with GLP, GCP and cGMP and other applicable government regulations and corresponding standards. There can be no assurance that the FDA, DEA or other regulatory agencies will find our contract research and development activities to be in compliance with GLP, GCP and cGMP requirements or other applicable requirements. If we fail to achieve and maintain high laboratory testing standards, clinical research standards, or manufacturing standards in compliance with GLP, GCP and cGMP regulations, we may experience testing, research or manufacturing errors or results leading to problems that could seriously harm our business, financial condition and reputation and could result in significant legal liability. In the future, PharmaForm may conduct commercial manufacturing activities for our products or for our third-party customers that would increase our risks and potential liabilities. In addition, significant scale-up of manufacturing may require additional validation studies, which the FDA must review and approve.

FDA review of our product candidates and, consequently, approval of our product candidates in the United States, may be subject to delay given the locations of our clinical studies.

The FDA will generally accept an application for marketing approval based solely on non-U.S. clinical data meeting U.S. criteria if:

- the non-U.S. data is applicable to the U.S. population and U.S. medical practice;
- the studies have been performed by clinical investigators of recognized competence; and

- the data may be considered valid without the need for an on-site inspection by the FDA, or, if the FDA considers such an inspection to be necessary, the FDA is able to validate the data through an on-site inspection or other appropriate means.

We have primarily conducted clinical trials for our lead product candidate, Fentanyl TAIFUN®, and our other product candidates outside the United States at study sites in Canada, Estonia, Finland, France, Germany, Italy, Latvia, Lithuania, Moldova, Poland, Romania, Serbia, the Netherlands, Ukraine, and the United Kingdom. To the extent the FDA deems it necessary to conduct an on-site inspection as described above, our applications for marketing approval may be delayed longer than similarly situated companies that have conducted trials in the United States. In addition, though we believe that our non-U.S. data is applicable to the U.S. population and U.S. medical practice, the FDA has not yet concluded so and if the FDA were to question our non-U.S. data, our applications for marketing approval might be delayed longer than similarly situated companies that have conducted trials in the United States or may not be approved at all.

Should the FDA, contrary to our expectations, not consider our non-U.S. data applicable to the U.S. population, we would need to increase the number of U.S. study sites in the Phase III program, or conduct the Phase III program entirely in the United States, which consequences could result in a higher cost, a delay of the clinical program, or both.

FDA approval for our product candidates in the United States could be delayed if our competitors obtain FDA approval for a competitive product before we do.

As an alternate path to FDA approval for new indications or improved formulations of previously approved products, a company may submit a Section 505(b)(2) New Drug Application (“NDA”), instead of a “stand-alone” or “full” NDA filing under Section 505(b)(1). Section 505(b)(2) of the *Federal Food, Drug, and Cosmetic Act* (United States) (“**FFDCA**”), was enacted as part of the *Drug Price Competition and Patent Term Restoration Act of 1984* (United States), otherwise known as the Hatch-Waxman Amendments. Section 505(b)(2) permits the submission of an NDA where at least some of the information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference. This provision allows the FDA to rely for approval of the NDA on data not developed by the applicant, such as published literature or the agency’s finding of safety and effectiveness of a previously approved drug.

Under the Hatch-Waxman Amendments, in the United States newly approved drugs and indications benefit from a statutory period of non-patent marketing exclusivity. The Hatch-Waxman Amendments prohibit the submission of an abbreviated new drug application (“**ANDA**”), or a Section 505(b)(2) NDA for a drug product that references the newly approved drug for a five-year period, except that the ANDA or 505(b)(2) application may be submitted after four years if it contains a Paragraph IV certification of patent invalidity or non-infringement. A Section 505(b)(2) application may itself be granted five years of exclusivity if it is for a new chemical entity. Protection under the Hatch-Waxman Amendments will not prevent the submission or approval of another “full” or “stand-alone” NDA; however, the applicant would be required to conduct its own non-clinical and adequate and well-controlled clinical trials to demonstrate safety and effectiveness. The Hatch-Waxman Amendments also provide three years of marketing exclusivity for the approval of new and supplemental NDAs, including Section 505(b)(2) NDAs, for, among other things, new indications, dosages, or strengths of an existing drug, if new clinical investigations, other than bioavailability studies, that were conducted or sponsored by the applicant are essential to the approval of the application containing those changes. The Hatch-Waxman Amendments prohibit the FDA’s approval of an ANDA or a 505(b)(2) NDA for a drug product that references the newly approved drug for a three-year period. A 505(b)(2) NDA may itself be granted three years of exclusivity if it contains new clinical investigations, other than bioavailability studies, that were conducted or sponsored by the applicant and that are essential to the approval of the application. The five-year and three-year periods may be extended by up to two periods of six-month exclusivity for the submission of pediatric studies.

If the FDA approves another company’s version of our product candidates, such as GHRH, before it approves our product candidate, and awards that company five-year marketing exclusivity for a new chemical entity, then we could not submit a 505(b)(2) application for that product candidate for at least four years. However, since our GHRH has a unique amino acid sequence and is considered a new chemical entity different from other GHRH compounds, we will need to submit a full 505(b)(1) NDA. Therefore, data protection relating to other companies’ GHRH compounds should not extend to our GHRH. In addition, if the FDA approves another company’s version of

our product candidates, such as a dry-powder form of inhaled fentanyl, before it approves our product candidate, such as Fentanyl TAIFUN®, and awards that company three-year marketing exclusivity for a new clinical study, then we could not receive FDA approval of our 505(b)(2) application for that product candidate for at least three years.

The regulatory approval process is expensive, time-consuming and uncertain and may prevent us from obtaining approvals for the commercialization of some or all of our product candidates.

The research, testing, manufacturing, packaging, labeling, approval, storage, selling, marketing and distribution of drug products are subject to extensive regulation in the United States by the FDA, in Canada by the Therapeutics Products Directorate (“TPD”) and by similar regulatory authorities in the European Union, Japan and elsewhere, and regulations and requirements differ from country to country. We are not permitted to market our product candidates in the United States until we receive approval of an NDA, or Biologics License Application (“BLA”) from the FDA. We have not submitted an application for or received marketing approval for any of our product candidates. Obtaining approval can be a lengthy, expensive and uncertain process.

The FDA has substantial discretion in the drug approval process. Despite the time and expense exerted by us, failure can occur at any stage, and we could encounter problems that cause us to abandon clinical trials or to repeat or perform additional preclinical studies and clinical trials. The number of preclinical studies and clinical trials that will be required for FDA approval varies depending on the drug candidate, the disease or condition that the drug candidate is designed to address, and the regulations applicable to any particular drug candidate. The FDA can delay, limit or deny approval of a drug candidate for many reasons, including:

- a drug candidate may not be deemed safe or effective;
- the FDA may not find the data from preclinical studies and clinical trials sufficient;
- the FDA may not approve our third-party manufacturer’s processes or facilities;
- the FDA may change its approval policies or adopt new regulations; or
- third-party products may enter the market and change approval requirements.

Our operations and facilities are subject to ongoing governmental review. Development, manufacturing, labeling, and promotional activities are continually regulated by the FDA, DEA and certain non-U.S. regulatory bodies, and we must also report certain adverse events involving our products and those we service to these agencies. Previously unidentified adverse events or an increased frequency of adverse events at our facility could result in costly and time-consuming alterations, including temporary shutdown of our operations. In addition, approvals may be withdrawn if compliance with regulatory standards is not maintained. The restriction, suspension, or revocation of regulatory approvals or any other failure to comply with regulatory requirements could have a material adverse effect on our business, financial condition, and results of operations.

We are required to follow cGMP requirements and are subject to routine unannounced periodic inspections by the FDA, DEA and certain U.S. state and non-U.S. regulatory agencies for compliance with cGMP requirements and other applicable regulations. There can be no assurance that the FDA, DEA or other regulatory agencies will find our CRO or manufacturing process or facilities or other operations to be in compliance with cGMP requirements and other regulations. Our failure to maintain satisfactory compliance with cGMP could have a material adverse effect on our ability to continue to develop, produce, market and distribute our product candidates and, in the most serious cases, could result in the issuance of warning letters, seizure or recall of products, civil penalties or closure of our development and manufacturing facilities until such cGMP compliance is achieved.

Failure to comply with regulatory authorities or applicable regulatory requirements may, either before or after product approval, if any, subject us to administrative or judicially imposed sanctions.

Failure to comply with FDA, EMEA or other applicable U.S. and non-U.S. regulatory requirements may, either before or after product approval, if any, subject us to administrative or judicially imposed sanctions, including:

- restrictions on the products, manufacturers or manufacturing process;
- warning letters or untitled letters;
- civil and criminal penalties;
- injunctions;
- suspension or withdrawal of regulatory approvals;
- suspension of or holds on clinical trials;
- product seizures, detentions or import bans;
- product recalls and publicity requirements;
- total or partial suspension of production;
- imposition of restrictions on operations, including costly new manufacturing requirements, via consent decrees or other administrative action; and
- refusal to approve pending NDAs or BLAs or supplements to approved NDAs or BLAs.

Regulatory approval of an NDA, NDA supplement, BLA or BLA supplement is not guaranteed, and the approval process is very expensive and may take several years, if it occurs at all.

Failure to maintain DEA registration and licensing or compliance with DEA requirements could prevent us from marketing our product candidates in the United States.

Our product candidates may be strictly regulated by the DEA. The DEA closely regulates those drugs that are defined as controlled substances or listed chemicals by the *Controlled Substances Act* (United States) and its amendments and implementing regulations. Under U.S. federal law, a person, including an individual or corporation, who manufactures, distributes, dispenses, imports, or exports any controlled substance, or who proposes to engage in these activities, must register with the DEA, unless exempt. In addition, manufacturers are subject to DEA-established procurement, production, and manufacturing quotas. Registrants must comply with a series of regulatory requirements, and have detailed procedures in place, relating to drug labeling, packaging, security, shipment and disposal; customer, clinical investigator, or other shipper licensure; employee limitations and controls; transaction reporting; records accountability; inventory maintenance; and diversion control procedures. Although we have taken steps to ensure compliance with DEA requirements, including DEA registration and licensure, we cannot guarantee that DEA will determine that our activities comply with current or future DEA regulations. The DEA has the authority to enter and inspect our facilities at any time. There may be similar regulatory issues in other non-U.S. jurisdictions.

Failure to obtain regulatory approval outside the United States would prevent us from marketing our product candidates in such jurisdictions.

We intend to market certain of our product candidates in non-U.S. markets. In order to market our product candidates in the European Union and many other jurisdictions, we must obtain separate regulatory approvals. The approval procedures vary among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. Approval by the regulatory authorities in one country does not ensure approval by regulatory authorities in other countries. The non-U.S. regulatory approval process may include all of the risks associated with obtaining FDA approval. We may not obtain regulatory

approvals on a timely basis, if at all. We may not be able to file for regulatory approvals and may not receive necessary approvals to commercialize our product candidates in any market. Once we obtain regulatory approvals in any jurisdiction, we will be subject to post-approval requirements and non-compliance with these requirements could result in enforcement actions against us.

Even if we obtain regulatory approvals for our product candidates, the terms of approvals and ongoing regulation of our product candidates may limit how we manufacture, distribute and market our product candidates, which could materially impair our ability to generate revenue.

Even if we or our collaborators obtain regulatory approval for a drug candidate, we will be subject to post-marketing regulatory obligations, including requirements to:

- maintain records regarding product safety; and
- report to regulatory authorities adverse events.

The occurrence of unanticipated serious adverse events or other safety problems could cause the regulatory authorities to:

- impose significant restrictions on the indicated uses for which the product may be marketed;
- impose other restrictions on the distribution or sale of the product;
- require labeling changes that affect the risk-benefit ratio of the drug; or
- require potentially costly post-approval studies.

In addition, post-market discovery of any previously unknown safety problem could result in withdrawal of the product from the market and product recalls. Compliance with extensive post-marketing recordkeeping and reporting requirements requires a significant commitment of time and funds, which may limit our ability to commercialize approved product candidates.

In addition, manufacturing of approved drug products must comply with extensive regulations governing cGMP. Manufacturers and their facilities are subject to continual review and periodic inspections. Failure to comply with cGMP requirements could result in a suspension of manufacturing, product recalls or even withdrawals from the market. As we will be dependent on third parties for manufacturing, we will have limited ability to ensure that any entity manufacturing products on our behalf is doing so in compliance with applicable cGMP requirements. Failure or delay by any manufacturer of our products to comply with cGMP regulations or to satisfy regulatory inspections could have a material adverse effect on us, including potentially preventing us from being able to supply products for clinical trials or commercial sales. In addition, manufacturers may need to obtain approval from regulatory authorities for product, manufacturing, or labeling changes, which requires time and money to obtain and can cause delays in product availability.

There are extensive post-approval requirements related to the sale and marketing of pharmaceutical products in many jurisdictions, including laws governing approved labeling, comparisons to competing products' off-label promotion, scientific/educational grants, gifts, and adverse event monitoring and post-marketing reporting.

Compliance with extensive regulatory requirements requires training and monitoring of the sales force, which would impose a substantial cost on us and our collaborators. To the extent our products, when and if we have any, are marketed by our collaborators, the ability to ensure their compliance with applicable regulations will be limited. Failure to comply with applicable legal and regulatory requirements may result in:

- issuance of warning or untitled letters by regulatory authorities, or both;
- fines and other civil penalties;

- criminal prosecutions and penalties;
- injunctions, suspensions or revocations of marketing licenses or approvals;
- suspension of any ongoing clinical trials;
- suspension of manufacturing;
- delays in commercialization;
- refusal by regulatory authorities to approve pending applications or supplements to approved applications filed by us or our collaborators;
- refusals to permit products to be imported or exported to or from the United States or Canada;
- detention or destruction of the imported product;
- restrictions on operations, including costly new manufacturing requirements; and
- product recalls or seizures.

In addition, the FDA, EMEA and non-U.S. regulatory authorities may change their policies and additional regulations may be enacted that could prevent or delay regulatory approval or impact the commercialization of our product candidates. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the United States, Canada or abroad. If we are not able to maintain regulatory compliance, we would likely not be permitted to market our product candidates and we may not achieve or sustain profitability.

Risks Related to Marketability and Commercialization

Our development strategy focuses on reformulations of off-patent drugs and others may develop similar reformulations of those same drugs.

Our product development strategy involves the reformulation of existing drugs with active ingredients that are off-patent. Our products, when and if we have any, are likely to face competition from other generic versions of such drugs. Regulatory approval for generic drugs may be obtained without investing in costly and time-consuming clinical trials. Because of substantially reduced development costs, manufacturers of generic drugs are often able to charge much lower prices for their products than the original developer of a product. If we face competition from manufacturers of generic drugs on products we may commercialize, the prices at which such products are sold and the revenues we receive may be reduced. Although the process of manufacturing the fentanyl drug powder used in our TAIFUN® inhalation device is patented, the composition of the powder is not, so our proprietary rights may not be sufficient to prevent others from commercializing an inhaled version of fentanyl for break-through cancer pain. We will, as a general principle, attempt to reduce the risk of generic competition by means of including proprietary drug delivery technology into all of our products and product candidates. However, our competitors may be able to use their own proprietary technologies to achieve similar results as our products and launch similar products which do not infringe our patents.

Even if we receive regulatory approval to market our product candidates, the market may not be receptive to our products.

Even if our product candidates obtain regulatory approval, resulting products may not gain market acceptance among physicians, patients, health care payors or the medical community. We believe that the degree of market acceptance will depend on a number of factors, including:

- timing of market introduction of competitive products;

- perceived extent of safety and efficacy of our product candidates;
- prevalence and severity of any side effects;
- potential advantages or disadvantages over alternative treatments;
- strength of supply, marketing and distribution support;
- price of our product candidates, both in absolute terms and relative to alternative treatments;
- physician and patient willingness to participate in any post-market surveillance program that is a prerequisite to prescribing or receiving the product candidate; and
- availability of coverage and reimbursement from government and other third-party payors.

In addition, by the time our products, if any, are ready to be commercialized there is risk that, any such product:

- will not be economical to produce or market at prices that will allow us to achieve profitability;
- will not be successfully marketed or achieve market acceptance;
- will not be preferable to existing or newly developed products marketed by third parties;
- will no longer be protected by patent terms; or
- will infringe proprietary rights held by third parties now or in the future that would preclude us from marketing any such product.

The failure to successfully introduce and market our products that are under development would have a material adverse effect on our business, financial condition, and results of operations.

We do not currently have our own marketing, sales and distribution capability needed to commercialize our product candidates and may not be able to develop it in the future.

We do not currently have a sales force or the resources to market, sell and distribute any of our product candidates. We intend, where possible and consistent with our strategy, to partner with local companies to market, sell and distribute our products. If we fail to successfully find marketing partners or fail to develop a sales force, the sales of our products and, therefore, our revenues, results of operations and losses could be materially adversely affected.

If our competitors develop and market products that are more effective, safer or less expensive than our product candidates, our clinical trials and commercial opportunities will be negatively impacted.

The life sciences industry is highly competitive, and we face significant competition from many pharmaceutical, biopharmaceutical and biotechnology companies that are researching and marketing products designed to address the indications for which we are currently developing products or for which we may develop products in the future. We are aware of several other companies, including BioDelivery Sciences International, Nektar Therapeutics, Aradigm Corporation and Alexza Pharmaceuticals, Inc., that are developing multiple dose inhalers, and others, such as Cephalon Inc. and YM Biosciences Inc. that have developed, or are developing, products for break-through cancer pain. Any products we may develop in the future are also likely to face competition from other drugs and therapies. Many of our competitors have significantly greater financial, manufacturing, marketing and drug development resources than we do. Large pharmaceutical companies, in particular, have extensive experience in clinical testing and in obtaining regulatory approvals for drugs. These companies also have significantly greater research and marketing capabilities than we do. In addition, many universities and private and public research institutes are, or may become, active in inhalation therapy and pain

research, the products of which may be in direct competition with us. If our competitors market products that are more effective, safer or less expensive than our product candidates, if any, or that reach the market sooner than our product candidates, if any, or achieve better market acceptance, we may not achieve commercial success.

Risks Associated with the Administration of Our Business

We may not be able to attract and retain key personnel to achieve our scientific and business objectives.

As a technology-driven company, intellectual input from key management, particularly Halvor Jaeger, our Chief Executive Officer, Taneli Jouhikainen, our Vice President Corporate Development, and our other scientists is critical to achieve our scientific and business objectives. Consequently, our ability to retain these individuals and attract other qualified individuals is critical to our success. The loss of the services of key individuals might significantly delay or prevent achievement of our scientific or business objectives. In addition, because of a relative scarcity of individuals with the high degree of education and scientific achievement required for our business, competition among life sciences companies for qualified employees is intense. As a result, even though we have not to date experienced problems attracting or retaining key management or scientists, in the future we may not be able to attract and retain such individuals on acceptable terms, or at all. Mr. Jaeger's employment agreement expires in 2010. Our employment arrangements with our key executives are terminable at will by us or the executive.

We also have relationships with scientific collaborators at academic and other institutions, some of whom conduct research at our request or assist us in formulating our research and development strategies. These scientific collaborators are not our employees and may have commitments to, or consulting or advisory contracts with, other entities that may limit their availability to us. In addition, these collaborators may have arrangements with other companies to assist such other companies in developing technologies that may prove competitive to us.

Further, we expect that our potential expansion into areas and activities requiring additional expertise, such as further clinical trials, governmental approvals, sales and marketing, will place additional requirements on our management, operational and financial resources. We expect these demands will require an increase in the number of management and scientific personnel and the development of additional expertise by existing management personnel. The failure to attract and retain such personnel, or to develop such expertise, could materially adversely affect prospects for our success.

Our current personnel may be inadequate and we may fail to assimilate and train new employees. Highly skilled employees with the education and training that we require, especially employees with significant experience and expertise in drug delivery systems, are in high demand. Once trained, our employees may be hired by our competitors.

We may encounter difficulties in managing our expected growth and in expanding our operations successfully.

As we advance our product candidates through development and clinical trials, we will need to develop or expand our development, regulatory, manufacturing, marketing and sales capabilities or contract with third parties to provide these capabilities for us. Maintaining additional relationships and managing our future growth will impose significant added responsibilities on our management. We must be able to:

- manage our development efforts effectively;
- manage our clinical trials effectively;
- hire, train and integrate additional management, development, manufacturing, administrative and sales and marketing personnel;
- improve our managerial, development, operational and finance systems; and
- expand our facilities.

Each of these responsibilities may impose a strain on our administrative and operational infrastructure. When we manufacture our own clinical supplies and/or product candidates, we expose ourselves to numerous operational and regulatory risks, which may delay our commencement of clinical trials or the commercialization of our products.

Furthermore, we may acquire additional businesses, products or product candidates that complement or augment our existing business. Integrating any newly acquired business, product or product candidate could be expensive and time-consuming. We may not be able to integrate any acquired business, product or product candidate successfully or operate any acquired business profitably. Our future financial performance will depend, in part, on our ability to manage any future growth effectively and our ability to integrate any acquired businesses. We may not be able to accomplish these tasks, and our failure to accomplish any of them could prevent us from successfully growing our company.

Our reliance on third parties to develop and distribute our products exposes us to a number of risks.

We may rely on collaboration, distribution or other partnering agreements because we do not have our own capabilities. We intend to secure agreements relating to the marketing and distribution of our products for which we may receive regulatory approval. If we are unable to reach agreements with suitable partners, we may fail to meet our business objectives for the affected product or program. We face, and will continue to face, significant competition in seeking appropriate partners. Moreover, collaboration, distribution and other partnering arrangements are complex and time-consuming to negotiate, document and implement. We may not be successful in our efforts to establish and implement such partnering arrangements upon satisfactory terms or at all.

We may rely on third parties to manufacture and supply our product candidates.

If, in the future, one of our product candidates is approved for commercial sale, we will need to manufacture that product candidate in commercial quantities and we do not expect to have the capability to do so on our own in the near term. We cannot assure you that the third-party manufacturers with which we contract will have sufficient capacity to satisfy our future manufacturing needs, or that we will be able to negotiate additional purchases of active pharmaceutical ingredient or drug product from manufacturers on terms favorable to us, or at all. Our contract manufacturers will have to employ precise, high-quality manufacturing processes and will be subject to ongoing periodic unannounced inspection by the FDA and non-U.S. regulatory authorities to ensure strict compliance with cGMP and other applicable government regulations and corresponding standards. Significant scale-up of manufacturing may require additional validation studies, which the FDA must review and approve. If we are unable to successfully increase the manufacturing capacity for a product candidate in conformity with cGMPs, the regulatory approval or commercial launch of any related products may be delayed or there may be a shortage in supply.

We may not be able to successfully acquire and integrate complementary technologies or businesses needed for the development of our business and any acquisitions we make could disrupt our business and harm our financial condition.

We may pursue product, technology or business acquisitions that could complement or expand our business. However, we may not be able to identify appropriate acquisition candidates in the future. If an acquisition candidate is identified, we may not be able to successfully negotiate the terms of any such acquisition or finance such acquisition. For example, in January 2007, we completed the acquisition of PharmaForm. We acquired our EDACS™ and PHARMAFILM™ technologies through this acquisition. The integration of PharmaForm and any similar acquisition could result in unanticipated costs or liabilities, diversion of management's attention from our core business, the expenditure of resources and the potential loss of key employees, particularly those of the acquired organizations. In addition, we may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future, which may harm our business.

Risks Associated with the Multinational Character of Our Business

We generate revenues and expenses in currencies other than the U.S. dollar and face exposure to adverse movements in foreign currency exchange rates.

We intend to generate revenue and expenses internationally which are likely to be denominated in Euros and other foreign currencies. Effective as of January 1, 2007, we determined that our functional currency is the U.S. dollar. Previously, our functional currency was the Canadian dollar. Our intended international business will be subject to risks typical of an international business including, but not limited to, differing tax structures, a myriad of regulations and restrictions, and general foreign exchange rate volatility. A decrease in the value of such foreign currencies relative to our functional and reporting currency, the U.S. dollar, could result in losses from currency exchange rate fluctuations. To date, we have not generated sufficient revenues to warrant the necessity of hedging against risks associated with foreign exchange rate exposure. Although we may do so in the future, we cannot be sure that any hedging techniques we may implement will be successful or that our business, results of operations, financial condition and cash flows will not be materially adversely affected by exchange rate fluctuations.

We may not achieve our projected development goals in the time frames we announce and expect.

We have and will set goals for and make public statements regarding our expected timing for meeting the objectives material to our success, such as the commencement and completion of clinical trials, anticipated regulatory approval and product launch dates. The actual timing of these forward-looking events can vary dramatically due to factors such as delays or failures in our clinical trials, the need to develop additional data required by regulators as a condition of approval, the uncertainties inherent in the regulatory approval process and delays in achieving manufacturing or marketing arrangements necessary to commercialize our product candidates.

Risks Related to Our Intellectual Property

Rapid technological change could make our products or drug delivery technologies obsolete.

Pharmaceutical technologies are subject to rapid and significant technological change. We expect our competitors will develop new technologies and products that may render our products and drug delivery technologies uncompetitive or obsolete. The products and drug delivery technologies of our competitors may be more effective than the products and drug delivery technologies developed by us. As a result, our products may become obsolete before we recover expenses incurred in connection with their development or realize revenues from any product.

Our proprietary rights may not adequately protect our technologies and product candidates.

Our commercial success will depend, in part, on our ability and the abilities of our licensors to obtain patents and/or regulatory exclusivity and maintain adequate protection for our technologies and product candidates in Canada, the United States, the European Union and other countries. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies and product candidates are covered by valid and enforceable patents or are effectively maintained as unpatented proprietary technology. If we do not adequately protect our intellectual property, competitors may be able to use our technologies and erode or negate any competitive advantage we may have, which could harm our business and ability to achieve profitability.

We and our licensors apply for patents and regulatory exclusivity covering our technologies and product candidates, as we deem appropriate. However, we may fail to apply for patents or regulatory exclusivity on important technologies or product candidates in a timely fashion, or at all. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products and technologies. In addition, we do not control the patent prosecution of subject matter that we license from others. Accordingly, we are sometimes unable to exercise the same degree of control over this intellectual property as we would over our own. Moreover, the patent positions of life sciences companies are highly uncertain and involve complex legal and factual questions for which important legal principles remain unresolved. As a result, the validity and enforceability of our patents cannot be predicted with certainty. In addition, we cannot guarantee that:

- we or our licensors were the first to make the inventions covered by each of our issued patents and pending patent applications;
- we or our licensors were the first to file patent applications for these inventions;

- others will not independently develop similar or alternative technologies or duplicate any of our technologies;
- any of our or our licensors' pending patent applications will result in issued patents;
- any of our or our licensors' patents will be valid or enforceable;
- any patents issued to us or our licensors and collaboration partners will provide us with any competitive advantages, will not be challenged by third parties, or will not be invalidated;
- any relevant patent will not expire or remain in force for sufficient time for us to capitalize on such patent;
- we will develop additional proprietary technologies that are patentable; or
- the patents of others will not have an adverse effect on our business.

The actual protection afforded by a patent varies on a product-by-product basis, from country to country and depends upon many factors, including:

- the type of patent;
- the scope of its coverage;
- the availability of regulatory related extensions;
- the availability of legal remedies in a particular country; and
- the validity and enforceability of the patents.

Our ability to maintain and solidify our proprietary position for our product candidates will depend on our success in obtaining effective claims and enforcing those claims once granted.

We also rely on trade secrets to protect some of our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to maintain. While we use reasonable efforts to protect our trade secrets, our or our collaboration partners' employees, consultants, contractors or scientific and other advisors may unintentionally or willfully disclose our proprietary information to competitors. Enforcement of claims that a third party has illegally obtained and is using trade secrets is expensive, time-consuming and uncertain. In addition, non-Canadian or U.S. courts are sometimes less willing than Canadian and U.S. courts to protect trade secrets. If our competitors independently develop equivalent knowledge, methods and know-how, we would not be able to assert our trade secrets against them and our business could be harmed.

Certain existing patents may adversely impact our ability to commercialize our EDACS™ technology.

We are aware of certain issued U.S. patents and related foreign counterparts that contain claims that might be infringed by product candidates which embody our EDACS™ technology. We could modify our EDACS™ technology to circumvent these patents; but, such modifications may be time-consuming and costly or may not be successful. If an EDACS™ product candidate infringes, or is alleged to infringe, a valid claim of a third-party patent, including these patents, we may choose or may be required to obtain a license or licenses under such patents. We cannot guarantee that we would be able to secure such license(s) on favorable terms or at all. Alternatively, we can seek a court judgment that such patent claims are invalid. Claims of issued patents are presumed to be valid, and any finding of invalidity would come, if at all, only following litigation that could prove lengthy and costly and/or unsuccessful. These patents could materially affect our ability to develop product candidates or commercialize any product candidates based on our EDACS™ technology.

Certain existing patents may adversely impact our ability to commercialize our CGRP product candidate.

We are aware of at least one issued U.S. patent owned by another entity relating to our CGRP product candidate which expires prior to 2012. Our CGRP product candidate is expected to enter the market no earlier than 2012 following completion of the requisite clinical trials and regulatory approval processes.

We may not be able to protect our intellectual property rights throughout the world.

Filing, prosecuting and defending patents and trademarks on all of our product candidates, products and product names, when and if we have any, in every jurisdiction would be prohibitively expensive. Competitors may use our technologies and our trademarks in jurisdictions where we, our subsidiaries or our licensors have not obtained patent and trademark protection. These products may compete with our products, when and if we have any, and may not be covered by any of our or our licensors' patent claims or other intellectual property rights.

The laws of some countries do not protect intellectual property rights to the same extent as the laws of Canada and the United States, and many companies have encountered significant problems in protecting and defending such rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents, trademarks and other intellectual property protection, particularly those protections relating to biotechnology and pharmaceuticals, which could make it difficult for us to stop the infringement of our patents. Proceedings to enforce our patent rights in foreign jurisdictions could result in substantial cost and divert our efforts and attention from other aspects of our business.

We have assigned certain intellectual property to our Barbados subsidiary, LAB International SRL ("LAB SRL"). There is no assurance these arrangements will be respected by the applicable authorities or that the relevant regulations will not be changed.

We have assigned certain intellectual property to LAB SRL and organized our foreign operations in part based on assumptions about the application of various tax laws, foreign currency exchange and capital repatriation laws and other relevant laws of a number of jurisdictions. While we believe that such assumptions are reasonable, there can be no assurance that taxing or other authorities will reach the same conclusion. In addition, if such jurisdictions were to change or modify such laws, we could also suffer adverse tax and financial consequences.

The patent protection for our product candidates or products may expire before we are able to maximize their commercial value which may subject us to increased competition and reduce or eliminate our opportunity to generate revenue.

The patents in our worldwide patent estate corresponding to our product candidates have U.S. expiration dates ranging from 2011 to 2020 and, when these patents expire, we may be subject to increased competition and we may not be able to recover our development costs. In some of the larger economic territories, such as the United States and Europe, patent term extension or restoration may be available to compensate for time taken during aspects of the product candidate's regulatory review. However, we cannot be certain that an extension will be granted or, if granted, what the applicable time period or the scope of patent protection afforded during any extended period will be. In addition, even though some regulatory agencies may provide some other exclusivity for a product candidate under its own laws and regulations, we may not be able to qualify the product candidate or obtain the exclusive time period.

We may incur substantial costs as a result of litigation or other proceedings relating to patent and other intellectual property rights and we may be unable to protect our rights to, or use of, our technology.

We are primarily responsible for the maintenance of our patents and enforcement of our rights with respect thereto, even where such patents are licensed from third parties. If we choose to go to court to stop someone else from using the inventions claimed in our patents or our licensed patents, that individual or company has the right to ask the court to rule that these patents are invalid and should not be enforced against that third party. These lawsuits are expensive and would consume time and other resources even if we were successful in stopping the infringement of these patents. In addition, there is a risk that the court will decide that these patents are invalid or unenforceable and that we do not have the right to stop the other party from using the inventions. There is also the risk that, even if the validity of these patents is upheld, the court will refuse to stop the other party on the ground that its activities do not infringe our rights. In some cases, these lawsuits would involve the government's application of patent-related rules to our situation and, therefore, the lawsuits could include government entities such as the FDA.

If we wish to use the technology or compound claimed in issued and unexpired patents owned by others, we will need to obtain a license from the owner, enter into litigation to challenge the validity or enforceability of the patents or incur the risk of litigation in the event that the owner asserts that we infringed its patents. The failure to obtain a license to technology or the failure to challenge an issued patent that we may require to discover, develop or commercialize our product candidates may have a material adverse impact on us.

If a third party asserts that we infringed its patents or other proprietary rights, we could face a number of risks that could seriously harm our results of operations, financial condition and competitive position, including:

- patent infringement and other intellectual property claims, which would be costly and time-consuming to defend, whether or not the claims have merit, and which could delay the regulatory approval process and divert management's attention from our business;
- substantial damages for past infringement, which we may have to pay if a court determines that our product candidates or technologies infringe a competitor's patent or other proprietary rights;
- a court prohibiting us from selling or licensing our product candidates or methods of use unless the third party licenses its patents or other proprietary rights to us on commercially reasonable terms, which it is not required to do; and
- if a license is available from a third party, we may have to pay substantial royalties or lump-sum payments or grant cross licenses to our patents or other proprietary rights to obtain that license.

The pharmaceutical and biotechnology industries have produced a proliferation of patents, and it is not always clear to industry participants, including us, which patents cover various types of products or methods of use, and which patents must be listed with the FDA. We cannot be certain that others have not filed patent applications that cover technology similar to ours, or that we or our licensors were the first to invent the technology covered by our or our licensors' issued patents or pending applications. The coverage of patents is subject to interpretation by the courts, and the interpretation is not always uniform. If we are sued for patent infringement, we would need to demonstrate that our product candidates or methods of use either do not infringe the patent claims of the relevant patent or that the patent claims are invalid, and we may not be able to do this. Proving invalidity, in particular, is difficult since it requires a showing of clear and convincing evidence to overcome the presumption of validity enjoyed by issued patents.

If another party files a U.S. patent application on an invention similar to ours, we may elect to participate in or be drawn into an interference proceeding declared by the U.S. Patent and Trademark Office ("U.S. PTO") to determine priority of invention in the United States. The costs of these proceedings could be substantial, and it is possible that such efforts would be unsuccessful, resulting in a loss of our U.S. patent position with respect to such inventions. Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, any uncertainties resulting from the initiation and continuation of any litigation could have a material adverse effect on our ability to raise the funds necessary to continue our operations. We cannot predict whether third parties will assert these claims against us or against the licensors of technology licensed to us, or whether those claims will harm our business. If we are forced to defend against these claims, whether they are with or without any merit, whether they are resolved in favor of or against us or our licensors, we may face costly litigation and diversion of management's attention and resources. As a result of these disputes, we may have to develop costly non-infringing technology, or enter into licensing agreements.

We may be subject to damages resulting from claims that we, or our employees or consultants, have wrongfully used or disclosed intellectual property rights of third parties.

Many of our employees were previously employed, and certain of our consultants are currently employed, at universities or biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although we have not received any claim to date, we may be subject to claims that these employees or consultants or employees of our partners or licensors of technology licensed by us have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of these current or former employers. Litigation may be

necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel.

If we fail to protect our trademark rights, competitors may be able to take advantage of our goodwill, which would weaken our competitive position, reduce our revenues and increase our costs.

We believe that the protection of our trademark rights is an important factor in product recognition, maintaining goodwill, and maintaining or increasing market share. We may expend substantial cost and effort in an attempt to register, maintain and enforce our trademark rights. If we do not adequately protect our rights in our trademarks from infringement, any goodwill that we have developed in those trademarks could be lost or impaired.

Third parties may claim that the sale or promotion of our products, when and if we have any, may infringe on the trademark rights of others. Trademark infringement problems occur frequently in connection with the sale and marketing of pharmaceutical products. If we become involved in any dispute regarding our trademark rights, regardless of whether we prevail, we could be required to engage in costly, distracting and time-consuming litigation that could harm our business. If the trademarks we use are found to infringe upon the trademark of another company, we could be liable for damages and be forced to stop using those trademarks, and as result, we could lose all the goodwill that has been developed in those trademarks.

Risks Related to Our Industry

Legislative actions, potential new accounting pronouncements, and higher insurance costs are likely to impact our future financial position or results of operations.

Future changes in financial accounting standards may cause adverse, unexpected revenue fluctuations and affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred with greater frequency and are expected to occur in the future, and we may make or be required to make changes in our accounting policies in the future. Compliance with changing regulations of corporate governance and public disclosure may result in additional expenses. Changing laws, regulations, and standards relating to corporate governance and public disclosure are creating uncertainty for companies such as us, and insurance costs are increasing as a result of this uncertainty.

If product liability lawsuits are successfully brought against us, we may incur substantial liabilities and may be required to limit commercialization of our product candidates.

We face an inherent risk of product liability lawsuits related to the products manufactured for third parties by PharmaForm and the testing of our product candidates. We will face an even greater risk if our product candidates are introduced commercially. An individual may bring a liability claim against us if one of our product candidates causes, or merely appears to have caused, an injury. Because we conduct clinical trials in humans, we face the risk that the use of our product candidates will result in adverse side effects. We cannot predict the possible harms or side effects that may result from our clinical trials. Although we have liability insurance in customary amounts with respect to each of our clinical trials, our insurance may be insufficient to cover any such events. We do not know whether we will be able to continue to obtain clinical trial coverage on acceptable terms, or at all. We may not have sufficient resources to pay for any liabilities resulting from a claim excluded from, or beyond the limit of, our insurance coverage.

If we cannot successfully defend ourselves against a product liability claim, we may incur substantial liabilities. Such liabilities, including expenses of litigation or settlements, or both, and the amount of any award imposed on us in excess of existing insurance coverage, if any, may have a material adverse impact on us and on the price of our common shares and could have a material adverse effect on our financial condition, business and results of operations. We have not currently obtained product liability insurance. Because of increasing cost and difficult underwriting standards, such insurance may not be available at all, may not be available on commercial terms or, if obtained, may be insufficient to satisfy asserted claims.

Litigation may result in financial losses or harm our reputation and may divert management resources.

Public companies, like ours, may be the subject of certain claims, including those asserting violations of securities laws and derivative actions.

We cannot predict with certainty the eventual outcome of any future litigation or third-party inquiry. We may not be successful in defending ourselves or asserting our rights in new lawsuits, investigations or claims that may be brought against us, and, as a result, our business could be materially harmed. These lawsuits, investigations or claims may result in large judgments or settlements against us, any of which could have a negative effect on our financial performance and business. Additionally, lawsuits and investigations can be expensive to defend, whether or not the lawsuit or investigation has merit, and the defense of these actions may divert the attention of our management and other resources that would otherwise be engaged in running our business.

We are subject to the risks associated with the use of hazardous materials in our research and development.

Our research and development activities at our Austin, Texas facility involve the use of hazardous materials and chemicals. We are subject to U.S. federal, state and local laws and regulations and non-U.S. laws and regulations governing the use, manufacture, storage, handling and disposal of such materials and certain waste products. Although we believe that our safety procedures for handling and disposing of such materials will comply with the standards prescribed by U.S. federal, state and local regulations and non-U.S. regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed our resources and available insurance coverage. Currently, PharmaForm maintains general liability coverage in the amount of U.S.\$1,000,000 per occurrence. If we are required to institute additional safety procedures because we are found not to be in compliance or if more stringent or additional regulations are adopted, we may be required to incur significant costs to comply with environmental laws and regulations, which might have a material adverse effect on our business, financial condition and results of operations.

Additional information relating to the Company is available on SEDAR'S website @ www.sedar.com.

On behalf of Management,



Andrew Reiter, CA
Chief Financial Officer
Montreal, Quebec, Canada
March 28, 2008