

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following information should be read in conjunction with the unaudited interim consolidated financial statements of Ambrilia Biopharma Inc. ("Ambrilia" or the "Company") for the period ended June 30, 2007 and related notes included herein, together with the Company's audited consolidated financial statements for the year ended December 31, 2006 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts shown are stated in Canadian dollars. This review was prepared by management from information available to August 1, 2007. Additional information relating to the Company, including the Company's Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

### **FORWARD LOOKING STATEMENTS**

Except for the historical information, matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations may constitute forward-looking statements that are subject to certain risks and uncertainties that could cause actual results to differ materially from any future results, performance or achievements expressed or implied by such statements. Statements that are not historical facts, including statements preceded by, followed by, or that include the words "believes", "anticipates", "intends", "plans", "expects", "estimates", "should" or similar statements are forward-looking statements. Such statements reflect management's current views and are based on certain assumptions. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of this day. Such risks and uncertainties include the risks disclosed in "Risk Factors" and the effect of misjudgements in the course of preparing forward-looking statements. Actual results could differ materially from those currently anticipated as a result of a number of factors, such as risks and uncertainties generally experienced in the biotechnology industry, including changing market conditions, successful and timely completion of clinical studies, uncertainties related to the regulatory approval process, establishment of corporate alliances and other risks and uncertainties discussed in the filings of Ambrilia with Canadian regulatory authorities. Such statements are also based on various assumptions, including the successful and timely completion of clinical studies on Ambrilia's products demonstrating efficacy and safety for human use, their successful commercialization within the forecasted timelines and the attainment of the forecasted milestone payments and other revenues. While Ambrilia anticipates that subsequent events and developments may cause Ambrilia's views to change, Ambrilia specifically disclaims any obligation to update these forward-looking statements, unless obliged to do so by applicable securities legislation.

### **OVERVIEW AND OUTLOOK**

Ambrilia Biopharma Inc. is a publicly-traded (TSX:AMB) biopharmaceutical company actively engaged in the discovery and development of innovative small molecules and peptides to treat infectious diseases and cancer. The company leverages its R&D know-how in anti-virals and its expertise in delivery system technology, bringing products through clinical trials and then evaluating various development and licensing strategies for further advancement.

Ambrilia's pipeline includes: Octreotide, an improved formulation of an existing drug, developed with a patented technology, to treat acromegaly and some digestive tumors; a new formulation of Goserelin, developed in-house, to treat hormone-sensitive prostate cancer; PCK3145, a therapeutic non-toxic peptide for the treatment of advanced hormone-resistant prostate cancer; an integrase inhibitor program to treat HIV/AIDS; TVT, a drug delivery technology that selectively delivers anti-cancer agents to the vasculature of solid tumors and surrounding tumor cells; and several other early-stage anti-virals and immunomodulators. In October 2006, Ambrilia granted to an affiliate of Merck & Co., Inc., exclusive worldwide rights to its HIV protease inhibitor program, including lead compound PPL-100. The Company also has a novel biomarker for the diagnosis and prognosis of prostate cancer, PSP94.

Octreotide is a therapeutic alternative to Novartis' Sandostatin® LAR (Long-Acting Release). Ambrilia has developed an improved prolonged release formulation which was found to have a longer bioavailability than the original product and should therefore present an advantage in terms of convenience. The Phase III clinical efficacy study in acromegalics is ongoing and results are expected to be available in early 2008. Data from the safety studies should therefore be available around mid 2008. Thereafter, it is expected that the Company's

licensing partners will start the regulatory filings during the course of 2008, beginning in Europe and followed by North America.

Ambrilia's licensing partners for the worldwide sales and marketing of Octreotide are Mallinckrodt, a division of Tyco Healthcare, for the U.S., Teva Europe for France, Germany, Benelux, Spain and Scandinavia, and other specialized pharmaceutical and distribution companies for the rest of Europe, Canada and other countries. On July 17, 2007, the Company completed a licensing and distribution partnership with Shin Poong Pharmaceutical for South Korea.

Goserelin is a therapeutic alternative to Astra Zeneca's Zoladex® three months biodegradable implant, for which the Phase I/II single-dose study in hormone-sensitive prostate cancer patients is expected to start towards the end of 2007. Ambrilia will then seek a licensing partner for the commercialization of this product in Europe.

On June 13, Ambrilia presented preclinical data on its novel HIV integrase inhibitors at the XVI International HIV Drug Resistance Workshop. The data showed their potential distinct mechanism of action, which may lead to a different resistance profile from known integrase inhibitors currently in clinical development. The Company will continue to make further progress in its HIV integrase inhibitor program with the goal of having a potential preclinical drug candidate within the next 12 months.

At the same venue, Ambrilia co-authored with Dr. Mark Wainberg from McGill University, Merck & Co.'s abstract on PPL-100 which established the structural basis for the favorable resistance profile of the compound. The Company continues to follow-up with Merck in their advancement of PPL-100 towards development in HIV/AIDS patients.

Results of the U.S. pilot safety study amendment (4 months exposure) with PCK3145 ("Tigapotide") in hormone-resistant prostate cancer patients confirmed the favorable safety and tolerability of the drug, and suggested clinical activity in such patients. These findings justify the further development of Tigapotide and Ambrilia is currently evaluating various partnering and product development strategies to move forward with this drug.

Ambrilia continues exploring the possibilities of its TVT Technology and is currently setting up a preclinical program for anti-cancer agents to be integrated into the TVT delivery system. The Company is also pursuing the evaluation of several other technologies generated in its own laboratories, principally in the field of viral diseases.

Finally, Ambrilia aims to license-out its PSP94 diagnostic/prognostic product for prostate cancer and obtain the CE mark, a mandatory mark for most products sold in the European market, for this product.

On March 1, 2007 the Company acquired an additional 2.82% of the outstanding shares of Ambrilia Biopharma France S.A. ("Ambrilia France"), in exchange for 448,294 common shares of Ambrilia with a fair value of \$1,434,541, based on the \$3.20 weighted-average closing price of the Company's common shares for the five trading days around January 19, 2006, the date on which the acquisition was first announced. This transaction increased the Company's ownership of Ambrilia France to 94.29%. In addition, the Company has the option under a share purchase agreement to acquire an additional 5.64% of the outstanding shares of Ambrilia France in two tranches by April 2008, which will bring its ownership to 99.93%.

On April 18, 2007 the Company announced the appointment of Stephen G. Sudovar, the Chairman of its Board of Directors, as Executive Chairman and interim Chief Executive Officer. Hans J. Mader left his position as President and Chief Executive Officer and as a member of the Board effective on the same date. On June 13, 2007, Mr. Sudovar resigned from the above position and as a member of the Board of Directors for personal reasons. On the same date, Mr. Frederic Porte was appointed as Chairman of the Board of Directors.

On May 18 and May 22, 2007 Ambrilia issued, by way of a private placement, 2,417,353 common shares at a price of \$2.42 per share, for an aggregate consideration of \$5,849,995, before cash issue expenses of \$189,127.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. The reported amounts and note disclosures in the consolidated financial statements are determined using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. Actual results, however, may differ from the estimates used in the consolidated financial statements and such differences could be material. Details of our critical accounting estimates were reported in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2006 and these continue to apply for the six months ended June 30, 2007.

## **RESULTS OF OPERATIONS**

### **Quarter ended June 30, 2007 compared with the Quarter ended June 30, 2006**

The Company incurred a net loss of \$6,755,307 or \$0.22 per common share for the second quarter of 2007, compared with a net loss of \$6,003,787 or \$0.22 per common share for the same quarter last year.

### **Revenues**

Revenues for the second quarter of 2007 were \$202,755, compared with \$170,549 in the corresponding quarter last year. The higher revenues resulted primarily from an increase in interest income, due to higher interest rates in the current quarter compared to the second quarter of 2006.

Until the fourth quarter of 2006, when the Company received an up-front fee of \$19.1 million on the grant of exclusive worldwide rights to the Company's protease inhibitor program to an affiliate of Merck & Co., the Company's revenues were earned primarily from interest on available cash and short-term investments. We expect to continue to receive interest revenues during the next several years, as well as licensing revenues to be earned as our products advance through clinical development.

### **Research and Development Expenses**

Research and development expenses amounted to \$2,283,480 in the second quarter of 2007, compared with \$3,382,913 in the same quarter last year. The decrease of \$1,099,433 resulted primarily from the decreased R&D expenditures for PPL-100 following its licensing to an affiliate of Merck & Co., Inc. in October 2006 and lower spending on Octreotide. Research and development tax credits decreased to \$96,300 in the current quarter from \$464,076 in the corresponding quarter last year. The reduction in the current quarter reflects the lower spending compared to the second quarter of 2006 and the fact that the Company no longer qualifies for the 20% additional tax credit on the first \$2 million of eligible research expenditures in Quebec, since its total assets at December 31, 2006 exceeded \$75 million.

Our research and development expenses consist primarily of salaries and related personnel costs, fees paid to external service providers, laboratory supplies and costs for leasing of facilities and equipment. In the second quarter of 2007, fees paid to external service providers were primarily related to material for clinical studies for Octreotide and pre-clinical development of Goserelin.

We expect our research and development expenses to continue to be significant during the next few years as we continue our clinical trials for our more advanced products, while continuing to advance our other research programs. However, we are unable to estimate the specific timing and future costs of our research programs.

## **General and Administrative Expenses**

General and administrative expenses amounted to \$2,361,831 in the second quarter of 2007, an increase of \$838,564 over the total of \$1,523,267 for the same quarter last year. Increased compensation costs were the principal reason for the increased expenses, including amounts totalling \$700,000 payable to a former executive, in addition to a non-cash amount of \$100,000 paid in shares and a provision of \$77,700 for potential future payments.

## **Other Expenses**

Amortization expense increased to \$2,215,816 in the current quarter from \$2,101,646 in the same quarter last year. The increase resulted primarily from the added amortization on intellectual property arising from the acquisition of additional shares of Ambrilia France in September and October 2006 and in March 2007, all under the terms of the original offer to Ambrilia France shareholders made in January 2006.

Interest on long-term debt was \$261,568 in the second quarter of 2007, compared to \$285,977 in the same quarter last year. The decrease was mainly due to the reduced interest expense on the Biolevier loan as a result of the \$2 million loan repayment in December 2006, partially offset by interest capitalized to November 2006 and a higher interest rate in the current quarter compared to the second quarter of 2006.

Accretion expense on long-term debt amounted to \$90,052 in the second quarter of 2007 compared to \$61,973 in the same quarter of 2006. The increase in the current quarter results primarily from the change in accounting policy for deferred financing costs in accordance with CICA handbook section 3855, "Financial Instruments – Recognition and Measurement." This ongoing non-cash accounting charge for imputed interest will increase the carrying value of long-term debt to face value by the maturity date of each item.

Restructuring charges of \$251,120 were incurred in the second quarter of 2006 for severance and lease termination payments made following the acquisition of Ambrilia France. No restructuring charges were incurred in the current quarter.

The foreign exchange loss for the second quarter of 2007 amounted to \$68,085, compared to a gain of \$29,578 in the same quarter last year. The loss was due to the strengthening of the Canadian dollar against the Euro during the quarter.

As a consequence of the intellectual property arising on the acquisition of Ambrilia France, a future income tax liability of \$8,990,856 was recorded in 2006 as part of the acquisition equation for accounting purposes, which was increased by \$796,670 as a result of additional shares of Ambrilia France acquired in 2006 and by \$304,919 due to the shares acquired on March 1, 2007. This future income tax liability is being drawn down over a term of up to the 7-year period during which the intellectual property is being amortized.

For the second quarter of 2007, a future income tax expense of \$180,320 was reported, compared to a recovery of \$922,291 in the second quarter of 2006. The expense in the current quarter resulted primarily from the transfer of assets between different tax jurisdictions and was more than offset by a foreign exchange gain on the future income tax liability of \$416,147. In the corresponding quarter last year, the foreign exchange gain on the future income tax liability was \$44,329.

## **Six months ended June 30, 2007 compared with the Six months ended June 30, 2006**

The Company incurred a net loss during the six months ended June 30, 2007 of \$12,867,688 or \$0.43 per common share, compared with a net loss of \$8,966,617 or \$0.42 per common share in the corresponding period last year.

## **Revenues**

Revenues amounted to \$410,762 in the first half of 2007, compared with \$300,870 in the first half of 2006. The increase was primarily due to higher interest rates in the current period than in the same period last year.

## **Research and Development Expenses**

Research and development expenses for the first six months of 2007 were \$4,900,231, an increase of \$123,536 over the total of \$4,776,695 for the same period last year. The increase resulted primarily from higher compensation costs, in part due to the acquisition of Ambrilia France on March 1, 2006, and increased spending on octreotide and goserelin due to their inclusion for 6 months in the current period compared to 4 months in the same period last year. This was offset to a large extent by the decreased R&D expenditures for PPL-100 following its licensing to an affiliate of Merck & Co., Inc. in October 2006.

## **General and Administrative Expenses**

General and administrative expenses amounted to \$4,769,880 for the six months ended June 30, 2007, an increase of \$2,114,115 over the total of \$2,655,765 for the first half of 2006. The increase was primarily due to higher compensation costs, including amounts payable to a former executive in cash and shares totalling \$877,700 and higher directors' fees, together with increased professional fees and the inclusion of Ambrilia France for 6 months in the current period compared to 4 months in the same period last year.

## **Other Expenses**

Amortization expense increased to \$4,386,739 in the first half of 2007 from \$2,973,368 in the same period last year, reflecting the full effect of the added amortization on intellectual property arising from the acquisition of Ambrilia France.

Interest on long-term debt was \$520,934 in the first half of 2007, compared to \$552,593 in the same period last year. The decrease was mainly due to the lower interest expense on the Biolevier loan as a result of the \$2 million loan repayment in December 2006, partially offset by interest capitalized to November 2006 and higher interest rates in the current period than in the first half of 2006.

Accretion expense on long-term debt amounted to \$197,782 in the first half of 2007 compared to \$122,223 in the same period of 2006. The increase results primarily from the change in accounting policy for deferred financing costs which came into effect for the Company on January 1, 2007.

Restructuring charges of \$251,120 were incurred in the first half of 2006 following the acquisition of Ambrilia France. No restructuring charges were incurred in the current period.

The foreign exchange loss for the first half of 2007 amounted to \$54,824, compared to a loss of \$132,354 in the same period last year. The losses reflect changes in the relative value of the Canadian dollar against the Euro during the respective periods.

The future income tax recovery was \$910,985 for the first half of 2007, compared with \$1,246,876 in the first half of 2006. The recovery in the current period was lower as a result of the transfer of assets between different tax jurisdictions. In addition, a foreign exchange gain on the future income tax liability of \$309,158 was reported in the current period, compared with a foreign exchange gain on the future income tax liability of \$402,376 in the same period last year.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company has financed its operations and its acquisitions of technology and capital assets primarily through private placements and public issues of common shares and convertible debentures, scientific research investment tax credits and other government assistance, interest income and amounts received under licensing agreements for certain of its products.

Cash and cash equivalents and short-term investments totalled \$15,891,816 at June 30, 2007, compared with \$22,359,604 at December 31, 2006. The decrease of \$6,467,788 resulted from the utilization of \$10,657,282 to finance operating activities for the first half of 2007, including an increase of \$1,781,694 in non-cash working capital. In addition, a net amount of \$716,115 was used in the period for additional property, plant and equipment and intellectual property. Also, an amount of \$766,391 was utilized to repay an Ambrilia France

12% loan payable on March 1, 2007. Partially offsetting these cash outlays was a private placement of common shares in May 2007 that generated \$5,660,868, net of expenses. In addition, an amount of \$11,132 was obtained from the exercise of stock options.

Management believes that it will have sufficient funds available to support its ongoing activities for at least 12 months.

### **SIGNIFICANT PROJECTS**

Each of our product candidates, which were discussed in the Overview section, will have to complete the necessary phases of clinical trials and obtain regulatory approval before they can generate significant revenues. The costs to complete these clinical trials and to obtain regulatory approval are significant and the costs associated with this process are expected to continue to be significant over the next several years. Part of these costs could be borne by various corporate partners under research collaboration and licensing agreements.

### **CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS**

A summary of the Company's contractual obligations as at December 31, 2006 was disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2006. The amount of these contractual obligations did not change materially during the six months ended June 30, 2007.

The Company has not entered into any off-balance sheet arrangements during the six months ended June 30, 2007 and does not expect to enter into any, other than in the normal course of business, in the near future.

Commitments for capital expenditures as at June 30, 2007 amounted to \$105,000 and were for the purchase of equipment.

### **RELATED PARTY TRANSACTIONS**

There has been no material change during the six months ended June 30, 2007. However, the holder of one of the two \$100,000 loans under the Company's Employee Share Purchase Loan Program, the former President and CEO, left the Company effective April 18, 2007. By mutual agreement between the Company and the former President and CEO, the settlement of this loan will be deferred until a date to be determined by the Company, which shall be not later than December 31, 2008. The Company has a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the loan, and also to pay to the former President and CEO an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the loan balance.

The second loan is to the Executive Vice-President, Business Development, Licensing and IP and is due on April 11, 2013. These loans are presented as a reduction of shareholders' equity.

### **PROPOSED TRANSACTIONS**

The Company carries out a review of its strategic plan on a regular basis. At the present time, the Company has not entered into any agreements involving the acquisition or disposition by the Company of assets or businesses.

### **CHANGES IN ACCOUNTING POLICIES**

Section 3855, Financial Instruments – Recognition and Measurement; Section 1530, Comprehensive Income; and Section 3865, Hedges were all adopted effective January 1, 2007. Their adoption has no material impact on the Company's financial position or results of operations.

### **FINANCIAL INSTRUMENTS**

The Company does not use currency or other hedging instruments.

## **OUTSTANDING SHARE DATA**

As of August 1, 2007 the number of common shares outstanding is 31,989,612, an increase of 2,965,173 from December 31, 2006. The increase results from the issue of 448,294 shares in connection with the acquisition of additional shares of Ambrilia France, 2,417,353 shares issued in May 2007 by way of a private placement, 4,123 shares issued upon the exercise of stock options, 33,898 shares issued to the former President and CEO on the cessation of his employment with the Company and 61,505 shares issued as payment of interest for the first half of 2007 on the convertible debentures. The number of stock options outstanding at August 1, 2007 is 621,690, an increase of 2,309 from December 31, 2006. The increase resulted from a total of 155,932 new options having been granted during the period, partially offset by 128,250 options which expired, 21,250 options forfeited and 4,123 which were exercised. In addition, 10,201,519 warrants are outstanding on August 1, 2007, a decrease of 558,291 from December 31, 2006 resulting from the exercise of 448,294 acquisition warrants relating to the Ambrilia France acquisition, the expiry of 99,998 warrants issued in connection with the acquisition of Bioxalis Medica Inc. in 2005 and of 9,999 warrants issued as compensation with the issue of convertible debentures in 2005.

## **RISK FACTORS**

The Company's activities involve a number of risks and uncertainties that are generally experienced by the biotechnology industry. The future viability of Ambrilia depends upon its ability to successfully develop its technologies and products, to enter into licensing agreements and to obtain the regulatory approvals necessary to allow the products to be marketed.

### **Product Development and Regulatory Approvals**

Ambrilia can make no assurances that its products will be developed successfully, receive regulatory approval or achieve market penetration. Ambrilia's most advanced products are currently in the development stages and its other products are at the research stage. Its first product is designed to be a substitute for the drug Octreotide in its long-acting formulation. Only the results from the Phase III studies now ongoing will tell whether the potential advantages of Ambrilia's proprietary formulation are confirmed and whether the product has a chance to receive formal approval from the regulatory agencies.

Regarding its proprietary products, Ambrilia can make no assurances that its research and development programs will result in commercially viable products. To achieve profitable operation, Ambrilia, alone or with others, must successfully develop and market its products. To obtain regulatory approvals for the products being developed, clinical trials must demonstrate efficacy and that the products are safe for human use. Unsatisfactory results obtained from a particular study relating to a program may cause Ambrilia or its collaborators to abandon its commitment to that program. Ambrilia can make no assurances that any future animal or human test will yield favourable results.

Ambrilia can make no assurances that products based on its technology, if approved for marketing, will achieve market acceptance. The degree of market acceptance will depend on the efficacy and safety of the product candidates, their potential advantage over alternative products and treatment method. The lack of market acceptance would have a material adverse effect on Ambrilia's business and financial condition.

### **Uncertainty Regarding the Outcome of Clinical Studies**

In order for Ambrilia's products to obtain the approval of regulatory organizations and to gain a certain degree of commercial success, pre-clinical and clinical trials must demonstrate their safety and effectiveness. There can be no assurance that any particular study pertaining to any product or research and development program of Ambrilia will achieve satisfactory results. If results are not satisfactory, Ambrilia may have to reduce its commitment to such product or research and development program.

### **Commercialization**

Once commercialized, Ambrilia's products may potentially compete with existing products on the market. Various intermediaries in the healthcare sector, such as those who may prescribe or dispense the new drugs commercialized by Ambrilia and the parties responsible for drug reimbursement, may select other treatments

than those offered by Ambrilia. Furthermore, the prices of medical products are increasingly being regulated. Therefore, there can be no assurance that Ambrilia will be able to maintain price levels sufficient for the realization of an appropriate return on Ambrilia's investment in product development.

### **Price Controls**

In some countries, particularly the countries of the European Union, the pricing of prescription drugs is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time and delay the marketing of a product. In some countries, it may be necessary, in order to obtain reimbursement or pricing approval, to conduct clinical trials to compare the cost effectiveness of Ambrilia's product candidate to other available therapies. If reimbursement of Ambrilia's products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, Ambrilia's business could be adversely affected.

### **Capital Requirements**

To develop its products, Ambrilia requires significant investment of financial resources. Consequently, the ability of Ambrilia to obtain the cash needed to finance its operations is fundamental to its future success and therefore constitutes a business risk. Ambrilia's planned cash requirements may vary materially in response to a number of factors, including continued scientific progress in its products discovery and development program, progress in its preclinical evaluation of products and product candidates, time and expenses associated with filing, prosecuting and enforcing its patent claims, and costs associated with obtaining regulatory approvals. In order to meet such capital requirements, Ambrilia will consider collaborative research and development arrangements, and additional public or private financing (including the issuance of additional equity securities) to fund all or a part of particular programs. Ambrilia's ability to arrange such financing in the future will depend in part upon prevailing capital-market conditions as well as its business performance. There can be no assurances that Ambrilia will be successful in its efforts to arrange additional financing, if needed, on terms satisfactory to it. Such financing, if available, may result in dilution to existing Ambrilia shareholders. If adequate funds are not available, Ambrilia may have to substantially reduce or eliminate expenditures for research and development, testing, production and marketing of its proposed products, or obtain funds through arrangements with corporate partners that require it to relinquish rights to certain of its technologies or products.

With regards to the concentration of credit risk, investment tax credits recoverable are due from the Québec and French governments. The cash and cash equivalents are held with six Canadian chartered banks and one French bank. The short-term investments are held in bankers' acceptances of a major Canadian bank.

Since the beginning of its operations, Ambrilia has incurred significant losses and expects to continue to incur losses in the near future.

### **Personnel**

Ambrilia requires sophisticated management, research and development, marketing and sales, regulatory and clinical development personnel to develop its products. Success depends on Ambrilia's ability to attract, train and retain such personnel. The market for the highly-trained personnel Ambrilia requires is very competitive due to the limited number of people available with the necessary technical skills and understanding of Ambrilia's products and technologies. If Ambrilia fails to attract and retain qualified personnel, its business operations and product development efforts could suffer.

### **Intellectual Property Matters**

Ambrilia relies on patent, copyright, trade secret and trade-mark laws to limit the ability of others to compete with Ambrilia using the same or similar technologies. However, these laws afford only limited protection and may not adequately protect Ambrilia's rights to the extent necessary to sustain any competitive advantage Ambrilia may have.

Third parties may claim that Ambrilia's products infringe upon their intellectual property rights. This risk is exacerbated by the fact that the validity and breadth of medical technology patents involve complex legal and factual questions for which important legal principles remain unresolved.

In addition, because patents are not published until 18 months post-filing and can take many years to issue, there may be currently pending applications of which Ambrilia is unaware or which issue with an unexpected scope, such applications may later result in issued patents that Ambrilia's products infringe upon. There could also be existing patents of which Ambrilia is not aware that its products may infringe upon.

Furthermore, competitors may independently develop products similar to Ambrilia's or copy Ambrilia's products by circumventing Ambrilia's patents.

Patent applications relating to or affecting Ambrilia's business have been filed by a number of healthcare and biopharmaceutical companies. Some of these applications have been received. A number of technologies, applications or patents may conflict with its technologies or patent applications and such conflict could reduce the scope of patent protection which it could otherwise obtain or even lead to refusal of its patent applications. There is no assurance that Ambrilia could enter into licensing arrangements at a reasonable cost, or develop or obtain alternative technology in respect of patents issued to third parties that incidentally cover its products. Any liability to secure licenses or alternative technology could result in delays in the introduction of some of its products or even lead to prohibition of the development, manufacture or sale of certain products by Ambrilia. Moreover, Ambrilia could potentially incur substantial legal costs in defending legal actions which allege patent infringement or by instituting patent infringement suits against others.

It is not possible for Ambrilia to be certain that it is the creator of inventions covered by pending patent applications or that it was the first to file patent applications for any such inventions. No assurance can be given that its patents, once issued, would be declared by a court to be valid or enforceable, or that a competitor's technology or product would be found to infringe its patents.

Moreover, much of Ambrilia's know-how technology which is not patentable may constitute trade secrets. Therefore, Ambrilia requires its employees, consultants, advisors and collaborators to enter into confidentiality agreements. However, no assurance can be given that such agreements will provide for a meaningful protection of its trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure of information.

### **Product Liability Claims**

The testing and marketing of medical products, even after regulatory approval, has an inherent risk of product liability. Ambrilia obtains product liability insurance coverage in the total amount of \$5,000,000 relating to Phase I, II, and III clinical trials as required. It also maintains coverage for any claims arising from its previous clinical trials. However, these insurance coverages are limited guarantee and a product liability claim could potentially be greater than these coverages. Ambrilia's profitability would be adversely affected by a successful product liability claim in excess of its insurance coverage.

### **Rapid Technological Changes**

Ambrilia's industry is subject to rapid and substantial technological change. There can be no assurance that developments by others will not render Ambrilia's products or technologies non-competitive or that it will be able to keep pace with technological developments.

### **Competition**

Certain competitors of Ambrilia possess more financial resources than Ambrilia. Competitors have developed technologies that could be the basis for competitive products. Some of these products have an entirely different approach or means of accomplishing the desired therapeutic effect than products being developed by Ambrilia and may be more effective and less costly than the products developed by Ambrilia. In addition, other forms of medical treatment may compete with Ambrilia's products.

## **Unproven Market**

Ambrilia believes that there will be applications for products successfully derived from its core technologies and that the anticipated markets for products under development will continue to expand. However, no assurance can be given that these beliefs will prove to be correct owing, in particular, to competition from existing or new products and the yet to be established commercial validity of Ambrilia's products.

## **Government Regulation**

The procedure involved in obtaining regulatory approval from the government regulators in Canada, Europe and the United States to market therapeutic products is long and costly and may delay product development. The approval to market a product may be given to a limited extent only or it may be refused. Such limitations or refusals could be detrimental to Ambrilia's sales and profitability.

## **Hazardous Material and Environmental Matters**

Ambrilia's activities involve the controlled use of hazardous materials. Ambrilia is subject to federal, provincial and local laws and regulations governing the use, manufacturing, storage, handling and disposal of such materials and certain waste products. Although Ambrilia believes that its safety procedures for handling and disposing of such materials comply with the standards prescribed by such laws and regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. Should this occur, Ambrilia could be held liable for any damages that result, and any such liability could exceed its resources. Although Ambrilia believes that it is in compliance with environmental laws and regulations, and currently does not expect to make material capital expenditures for environmental control facilities in the near-term, there can be no assurance that it will not be required to incur significant costs to comply with environmental laws and regulations in the future, or that its operations, business or assets will not be materially adversely affected by current or future environmental laws or regulations.

## **Share Price Fluctuations**

The price of Ambrilia's common shares (the "Common Shares") is subject to fluctuation. Factors such as the conclusion of strategic alliances, research results and clinical studies, questions regarding patents, expectations of investors, securities, analysts, general market fluctuations and any number of other factors could considerably affect the price of the Common Shares.

Certain matters discussed in this annual information form are, by their nature, forward-looking and are subject to risks and other factors that are wholly or partially beyond the control of Ambrilia's management. Consequently, actual results could differ materially.

In recent years, the shares of many biopharmaceutical companies have experienced extreme price fluctuations, which have been unrelated to the operating performance of the affected companies. There can be no assurance that the market price of the Common Shares will not continue to experience significant fluctuations in the future, including fluctuations that are unrelated to Ambrilia's performance.

## **Payment of Dividends**

Ambrilia has never declared or paid any dividends on its Common Shares. Ambrilia currently intends to retain future earnings, if any, to finance further research and development and the expansion of its business. As a result, the return on an investment in the Common Shares will depend upon any future appreciation in value. There is no guarantee that the Common Shares will appreciate in value or even maintain the price at which they were purchased.

## **Foreign Currency Exchange**

Ambrilia operates and intends to generate revenue and expenses internationally, which are likely to be denominated in euros and other foreign currencies. Ambrilia's international business is subject to risks typical of an international business including, but not limited to, differing tax structures, myriad regulations and restrictions and general foreign exchange rate volatility. A decrease in the value of such foreign currencies

relative to the Canadian dollar could result in downward price pressure for Ambrilia's products in such jurisdictions or losses from currency exchange rate fluctuations. Ambrilia cannot be sure that any hedging techniques will be successful or that its business, results of operations, financial condition and cash flows will not be materially adversely affected by exchange rate fluctuations.

### **Value of Intangible Assets**

Ambrilia is required to review the carrying value of its intangible assets for impairment annually or when events change. Intangible assets include net book value of product rights, trademarks and process know-how covered by certain patented and non-patented information. Management reviews the carrying value based on projected future results. If events such as generic competition or inability to manufacture or obtain supply of product occur that may cause sales of the related products to decline, Ambrilia adjusts the projected results accordingly. Any impairment in the carrying value results in a write-down of the intangible asset, which is charged to income during the period in which the impairment is determined. The write-down of intangible assets may have a material adverse effect on the results of operations in the period in which the write-down occurs.

### **DISCLOSURE CONTROLS AND PROCEDURES**

The President and Chief Executive Officer and the Executive Vice-President, Finance and Chief Financial Officer are responsible for establishing and maintaining Ambrilia's disclosure controls and procedures. They are required to be fully apprised of any material information affecting the Company, so that they may review and evaluate this information in order to determine the appropriateness and timing of public releases.

The Executive Vice-President, Finance and Chief Financial Officer, the Senior Executive Vice-President and Chief Scientific Officer and the Vice-President, Legal Affairs, Human Resources and Corporate Secretary jointly performing the functions of the Chief Executive Officer on an interim basis, and the Executive Vice-President, Finance and Chief Financial Officer, having evaluated the effectiveness of the Company's disclosure controls and procedures as at June 30, 2007, have concluded that these disclosure controls and procedures are adequate and effective and thus would have ensured that material information relating to the Company would have been known to them.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Internal controls over financial reporting ("ICFRs") are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and its compliance with GAAP in its consolidated financial statements. The above-mentioned executives who are jointly performing the functions of the Chief Executive Officer on an interim basis and the Executive Vice-President, Finance and Chief Financial Officer, together with other members of management, have designed ICFRs in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with Canadian GAAP.

Management have concluded that no changes were made to ICFRs during the six months ended June 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED BALANCE SHEETS**

(unaudited)

As at

|   | June 30,<br>2007<br>\$ | December 31,<br>2006<br>\$ |
|---|------------------------|----------------------------|
| <b>ASSETS</b>                               |                        |                            |
| <b>Current assets</b>                       |                        |                            |
| Cash and cash equivalents                   | 11,471,071             | 3,155,854                  |
| Short-term investments                      | 4,420,745              | 19,203,750                 |
| Accounts receivable <i>[note 5]</i>         | 632,888                | 847,688                    |
| Investment tax credits recoverable          | 1,001,310              | 1,902,212                  |
| Prepaid expenses                            | 162,327                | 116,154                    |
|   | 17,688,341             | 25,225,658                 |
| Long-term receivables <i>[note 6]</i>       | 1,141,807              | 1,095,130                  |
| Property, plant and equipment               | 2,130,360              | 1,782,558                  |
| Intellectual property                       | 51,100,056             | 53,379,022                 |
| Deferred financing costs <i>[note 3]</i>    | -                      | 979,534                    |
|   | 72,060,564             | 82,461,902                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> |                        |                            |
| <b>Current liabilities</b>                  |                        |                            |
| Accounts payable and accrued liabilities    | 2,939,896              | 5,762,426                  |
| Deferred license revenues                   | 3,395,960              | 3,377,976                  |
| Loan payable                                | -                      | 768,841                    |
|   | 6,335,856              | 9,909,243                  |
| Minority interest                           | 1                      | 1                          |
| Biolevier loan facility                     | 8,146,727              | 8,927,466                  |
| Future income tax liability                 | 5,379,870              | 6,295,095                  |
| Convertible debentures                      | 2,407,546              | 2,408,559                  |
|   | 22,270,000             | 27,540,364                 |
| <b>Shareholders' equity <i>[note 7]</i></b> |                        |                            |
| Share capital                               | 121,736,532            | 114,401,167                |
| Warrants                                    | 6,143,141              | 6,143,141                  |
| Contributed surplus                         | 8,321,560              | 7,920,211                  |
| Equity component of convertible debentures  | 1,920,914              | 1,920,914                  |
| Deficit                                     | (88,331,583)           | (75,463,895)               |
|   | 49,790,564             | 54,921,538                 |
|   | 72,060,564             | 82,461,902                 |

See accompanying notes

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED STATEMENTS OF**  
**OPERATIONS, DEFICIT AND COMPREHENSIVE INCOME**  
(unaudited)

|   | Three months ended June 30, |              | Six months ended June 30, |              |
|---|-----------------------------|--------------|---------------------------|--------------|
|   | 2007                        | 2006         | 2007                      | 2006         |
|   | \$                          | \$           | \$                        | \$           |
| <b>REVENUES</b>   |                             |              |                           |              |
| License revenue   | 7,101                       | 6,762        | 14,465                    | 8,988        |
| Interest and other income                                   | 195,654                     | 163,787      | 396,297                   | 291,882      |
|   | <b>202,755</b>              | 170,549      | <b>410,762</b>            | 300,870      |
| <b>EXPENSES</b>   |                             |              |                           |              |
| Research and development                                    | 2,283,480                   | 3,382,913    | 4,900,231                 | 4,776,695    |
| Research and development tax credits                        | (96,300)                    | (464,076)    | (370,254)                 | (589,064)    |
| Net research and development                                | 2,187,180                   | 2,918,837    | 4,529,977                 | 4,187,631    |
| General and administrative                                  | 2,361,831                   | 1,523,267    | 4,769,880                 | 2,655,765    |
| Amortization of property, plant and equipment               | 132,506                     | 111,077      | 256,466                   | 174,180      |
| Amortization of intellectual property                       | 2,083,310                   | 1,951,814    | 4,130,273                 | 2,724,742    |
| Amortization of deferred financing fees                     | -                           | 38,755       | -                         | 74,446       |
| Accretion on long-term debt                                 | 90,052                      | 61,973       | 197,782                   | 122,223      |
| Interest on long-term debt                                  | 261,568                     | 285,977      | 520,934                   | 552,593      |
| Restructuring charges                                       | -                           | 251,120      | -                         | 251,120      |
| Financial charges   | 9,357                       | 27,714       | 38,457                    | 41,685       |
| Foreign exchange losses (gains)                             | 68,085                      | (29,578)     | 54,824                    | 132,354      |
|   | <b>7,193,889</b>            | 7,140,956    | <b>14,498,593</b>         | 10,916,739   |
| <b>Loss before income taxes</b>                             | <b>(6,991,134)</b>          | (6,970,407)  | <b>(14,087,831)</b>       | (10,615,869) |
| Future income tax recovery (expense)                        | (180,320)                   | 922,291      | 910,985                   | 1,246,876    |
| Foreign exchange gain on future income tax liability        | 416,147                     | 44,329       | 309,158                   | 402,376      |
|   | <b>235,827</b>              | 966,620      | <b>1,220,143</b>          | 1,649,252    |
| <b>Net loss and comprehensive loss</b>                      | <b>(6,755,307)</b>          | (6,003,787)  | <b>(12,867,688)</b>       | (8,966,617)  |
| Deficit, beginning of period                                | <b>(81,576,276)</b>         | (76,087,260) | <b>(75,463,895)</b>       | (73,124,430) |
| <b>Deficit, end of period</b>                               | <b>(88,331,583)</b>         | (82,091,047) | <b>(88,331,583)</b>       | (82,091,047) |
| <b>Basic and diluted loss per share</b>                     | <b>(0.22)</b>               | (0.22)       | <b>(0.43)</b>             | (0.42)       |
| <b>Weighted average number of common shares outstanding</b> | <b>30,648,112</b>           | 27,483,987   | <b>30,033,368</b>         | 21,605,997   |

See accompanying notes

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)

|   | Three months ended June 30, |                    | Six months ended June 30, |                    |
|---|-----------------------------|--------------------|---------------------------|--------------------|
|   | 2007                        | 2006               | 2007                      | 2006               |
|   | \$                          | \$                 | \$                        | \$                 |
| <b>OPERATING ACTIVITIES</b>                                   |                             |                    |                           |                    |
| Net loss  | (6,755,307)                 | (6,003,787)        | (12,867,688)              | (8,966,617)        |
| Items not affecting cash                                      |                             |                    |                           |                    |
| Amortization of property, plant and equipment                 | 132,506                     | 111,077            | 256,466                   | 174,180            |
| Amortization of intellectual property                         | 2,083,310                   | 1,951,814          | 4,130,273                 | 2,724,742          |
| Amortization of deferred financing fees                       | -                           | 38,755             | -                         | 74,446             |
| Accretion on long-term debt                                   | 90,052                      | 61,973             | 197,782                   | 122,223            |
| Loan interest capitalized                                     | -                           | 224,727            | -                         | 430,093            |
| Interest paid by issuance of common shares <i>[note 7]</i>    | 122,164                     | 122,164            | 122,164                   | 122,164            |
| Future income tax recovery and related foreign exchange gain  | (235,827)                   | (966,620)          | (1,220,143)               | (1,649,252)        |
| Foreign exchange loss (gain)                                  | (9)                         | 3,850              | (2,451)                   | 36,149             |
| Services paid by issuance of stock options <i>[note 7]</i>    | 88,476                      | 64,654             | 408,009                   | 136,035            |
| Compensation paid in shares <i>[note 7]</i>                   | (24,800)                    | -                  | 100,000                   | -                  |
|   | (4,499,435)                 | (4,391,393)        | (8,875,588)               | (6,795,837)        |
| Net change in non-cash balances relating to operations        | (260,371)                   | (350,250)          | (1,781,694)               | (1,947,546)        |
| <b>Cash flows related to operating activities</b>             | <b>(4,759,806)</b>          | <b>(4,741,643)</b> | <b>(10,657,282)</b>       | <b>(8,743,383)</b> |
| <b>INVESTING ACTIVITIES</b>                                   |                             |                    |                           |                    |
| Acquisition of intellectual property                          | (41,841)                    | (139,282)          | (143,157)                 | (147,161)          |
| Acquisition of property, plant and equipment                  | (361,440)                   | (115,420)          | (573,458)                 | (301,687)          |
| Proceeds on disposal of property, plant and equipment         | 500                         | 315                | 500                       | 315                |
| Cash and cash equivalents obtained on acquisition of business | -                           | -                  | -                         | 174,625            |
| Business acquisition costs                                    | -                           | -                  | -                         | (1,979,031)        |
| Purchase of short-term investments                            | (4,420,745)                 | (3,935,960)        | (5,410,025)               | (3,935,960)        |
| Maturities of short-term investments                          | 3,438,005                   | 986,730            | 20,193,030                | 4,942,205          |
| <b>Cash flows related to investing activities</b>             | <b>(1,385,521)</b>          | <b>(3,203,617)</b> | <b>14,066,890</b>         | <b>(1,246,694)</b> |
| <b>FINANCING ACTIVITIES</b>                                   |                             |                    |                           |                    |
| Issuance of common shares <i>[note 7]</i>                     | 5,849,995                   | -                  | 5,861,127                 | 18,095,904         |
| Share issuance costs <i>[note 7]</i>                          | (189,127)                   | (10,181)           | (189,127)                 | (1,223,610)        |
| Repayment of loan   | -                           | -                  | (766,391)                 | -                  |
| <b>Cash flows related to financing activities</b>             | <b>5,660,868</b>            | <b>(10,181)</b>    | <b>4,905,609</b>          | <b>16,872,294</b>  |
| Net increase (decrease) in cash and cash equivalents          | (484,459)                   | (7,955,441)        | 8,315,217                 | 6,882,217          |
| Cash and cash equivalents, beginning of period                | 11,955,530                  | 15,255,611         | 3,155,854                 | 417,953            |
| <b>Cash and cash equivalents, end of period</b>               | <b>11,471,071</b>           | <b>7,300,170</b>   | <b>11,471,071</b>         | <b>7,300,170</b>   |
| <b>Supplemental cash flow information</b>                     |                             |                    |                           |                    |
| Cash paid during the period for interest                      | 207,344                     | 7,669              | 483,751                   | 9,895              |

See accompanying notes

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007

(unaudited)

### **1. Description of business**

Ambrilia Biopharma Inc. [the “Company”] is a biopharmaceutical company engaged in the development and commercialization of diagnostics and therapeutic drugs. It was incorporated under the laws of the province of Ontario in 1986 and was continued under the Canada Business Corporations Act in 2001.

To date, the Company has financed its cash requirements primarily from equity and debt issuances, investment tax credits, government grants and loans, license revenues and interest income. The Company has incurred significant operating losses and cash outflows from its operations. The success of the Company is dependent upon bringing its technologies to market, obtaining the necessary regulatory approvals, obtaining additional financing and achieving future profitable operations.

### **2. Basis of presentation and significant accounting policies**

These interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles for interim financial statements and, except for the changes reported in note 3 below, follow the same accounting policies and methods of application as the most recent annual consolidated financial statements. The interim consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the most recent annual consolidated financial statements as at and for the year ended December 31, 2006.

#### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company, those of its 94.29%-owned French subsidiary, Ambrilia Biopharma France S.A. [“Ambrilia France”], those of its wholly-owned U.S. subsidiary, Oncologic Biopharmaceuticals Corporation [“Oncologic”], those of its wholly-owned Canadian subsidiaries, Bioxalis Medica Inc. [“Bioxalis”] and Opep Pharma Inc. [“Opep Pharma”], and those of its majority owned Canadian subsidiary, Cellpep Pharma Inc. [“Cellpep”]. All significant intercompany transactions and balances have been eliminated upon consolidation.

### **3. Changes in accounting policy**

Effective January 1, 2007, the Company adopted the following three recently introduced Canadian Institute of Chartered Accountants [“CICA”] Handbook Sections without restatement of prior periods.

Section 1530, “Comprehensive Income”, requires the presentation of comprehensive income and its components in the financial statements. Comprehensive income is the change in the net assets of a company arising from transactions, events and circumstances not related to shareholders.

Section 3855, “Financial Instruments – Recognition and Measurement”, sets out the standards for the recognition and measurement of financial assets, financial liabilities and derivatives. This standard prescribes when to recognize a financial instrument in the balance sheet and at what amount. Depending on their balance sheet classification, fair value or cost-based measures are used. This standard also prescribes the basis of presentation for gains and losses on financial instruments. Based on financial instrument classification, gains and losses on financial instruments are recognized either in net income or in other comprehensive income.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007

(unaudited)

**3. Changes in accounting policy (continued)**

The following table summarizes the Company’s financial instruments, their assigned classification, the initial and subsequent method of measurement and the treatment of their respective gains and losses:

| <b>Financial Instrument</b>              | <b>Classification</b>       | <b>Initial Measurement</b> | <b>Subsequent Measurement</b>                      | <b>Gains and Losses</b>  |  |
|--|-----------------------------|----------------------------|--|--|--|
| Cash                                     | Held for trading            | Fair-value                 | Fair-value   | Recognized immediately in net loss.  |  |
| Cash equivalents                         | Held to maturity            |                            | Amortized cost using the effective interest method | Recognized in net loss when the asset is derecognized. Impairment write-downs and foreign exchange translation adjustments recognized immediately in net loss. |  |
| Short-term investments                   |                             |                            |  |  |  |
| Accounts receivable <sup>(1)</sup>       | Loans and receivables       |                            |  |  |  |
| Long-term receivables <sup>(2)</sup>     |                             |                            |  |  |  |
| Accounts payable and accrued liabilities | Other financial liabilities |                            |  |  | Recognized in net loss when the liability is derecognized. Foreign exchange translation adjustment recognized immediately in net loss. |
| Biolevier loan facility                  |                             |                            |  |  |  |
| Convertible debentures                   |                             |                            |  |  |  |

(1) Excludes commodity taxes recoverable, as this amount is not a contractual right to receive cash.

(2) Excludes long-term investment tax credits, as this is not a contractual right to receive cash.

In addition, the Company now accounts for transaction costs related to the issuance of financial instruments as a reduction of the carrying value of the related financial instruments. As a result, the amounts previously reported as “Deferred financing costs” have been reflected at June 30, 2007 as a reduction of the “Biolevier loan facility” and the “Convertible debentures”. For more complete information, refer to notes 9 and 11 in the Company’s annual consolidated financial statements as at and for the year ended December 31, 2006. The Company does not have any outstanding contracts with embedded derivatives.

Section 3865, “Hedges” allows optional treatment providing that hedges be designated as either fair value hedges, cash flow hedges or hedges of a self-sustaining foreign operation. Since the Company does not currently have any hedging programs in place, the adoption of this section did not have any impact on the Company’s consolidated financial statements.

**4. Business acquisition**

On March 1, 2007, the Company exercised its call option to acquire the second 30% tranche of the 9.39% of the outstanding Ambrilia France securities covered by the share exchange agreement, issuing 448,294 common shares of the Company in exchange, which increased the Company’s ownership of Ambrilia France from 91.47% to 94.29%. The shares issued were valued at \$1,434,541, based on the \$3.20 weighted-average closing price of the Company’s common shares for the five trading days around January 19, 2006, the date on which the acquisition was first announced.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007

(unaudited)

#### 4. Business acquisition (continued)

Accordingly, an amount of \$1,708,150, \$31,310 and \$304,919 was assigned to intellectual property, property, plant and equipment and future income tax liability, respectively.

#### 5. Accounts receivable

|   | June 30, 2007  | December 31, 2006 |
|---|----------------|-------------------|
|   | \$             | \$                |
| Commodity taxes recoverable                   | 332,865        | 318,157           |
| Government assistance receivable              | -              | 183,534           |
| Interest receivable on short-term investments | 63,184         | 131,966           |
| Other   | 236,839        | 214,031           |
|   | <b>632,888</b> | <b>847,688</b>    |

#### 6. Long-term receivables

|  | June 30, 2007    | December 31, 2006 |
|--|------------------|-------------------|
|  | \$               | \$                |
| Deposits on long-term leases                             | 451,367          | 435,731           |
| Investment tax credits recoverable in more than one year | 690,440          | 659,399           |
|  | <b>1,141,807</b> | <b>1,095,130</b>  |

The deposits on long-term leases are interest-bearing, primarily at the rate payable on 30-day certificates of deposit of a Canadian chartered bank.

#### 7. Capital stock

##### Common shares

The Company is authorized to issue an unlimited number of common shares.

|   | Number of shares  | Share capital      |
|---|-------------------|--------------------|
|   |                   | \$                 |
| <b>Balance as at December 31, 2006</b>  | <b>29,024,439</b> | <b>114,401,167</b> |
| <b>Acquisition of Ambrilia France [note 4]</b>                                    |                   |                    |
| Shares issued March 1, 2007   | 448,294           | 1,434,541          |
| <b>Other</b>  |                   |                    |
| Stock options exercised   | 4,123             | 11,132             |
| Amount transferred from "Contributed surplus" relating to stock options exercised | -                 | 6,660              |
| Private placement <sup>(1)</sup>  | 2,417,353         | 5,660,868          |
| Issued as compensation <sup>(2)</sup>   | 33,898            | 100,000            |
| Issued in payment of interest on convertible debentures <sup>(3)</sup>            | 61,505            | 122,164            |
| <b>Balance as at June 30, 2007</b>  | <b>31,989,612</b> | <b>121,736,532</b> |

(1) On May 18 and 22, 2007, Ambrilia issued a total of 2,417,353 common shares by way of a private placement at a price of \$2.42 per share, for an aggregate consideration of \$5,849,995, before cash issue expenses of \$189,127.

(2) On May 24, 2007, Ambrilia issued 33,898 common shares to its former President and CEO as part of a settlement on the cessation of his employment with the Company. These shares are being held in escrow, with 50% to be released on October 18, 2007 and the balance on April 18, 2008.

**Ambrilia Biopharma Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007

(unaudited)

**7. Capital stock (continued)**

- (3) On June 29, 2007, the Company elected to issue 61,505 common shares as payment for the cumulative interest for the six months ended on that date on the \$3,500,000 convertible debentures maturing June 29, 2010.

**Warrants**

|  | <b>Number of common<br/>shares reserved for<br/>issuance</b> | <b>\$</b>        |
|--|--|------------------|
| <b>Balance as at December 31, 2006</b> | <b>10,759,810</b>  | <b>6,143,141</b> |
| Expired warrants                       | (109,997)  | -                |
| Exercise of acquisition warrants       | (448,294)  | -                |
| <b>Balance as at June 30, 2007</b>     | <b>10,201,519</b>  | <b>6,143,141</b> |

On March 15, 2007, the 99,998 warrants related to the Bioxalis acquisition expired without value. These warrants previously had no value attributed to them, since it was not determinable at the time of granting.

On June 29, 2007, a total of 9,999 compensation warrants for convertible debentures expired without value.

**Stock option plan**

As at June 30, 2007, there were 619,940 stock options outstanding, compared to 619,381 at December 31, 2006.

|   | <b>Number</b>  | <b>Six months ended June 30,</b>                      |               |   |
|---|----------------|---|---------------|---|
|   |                | <b>2007</b>   | <b>2006</b>   |   |
|   |                | <b>Weighted<br/>average<br/>exercise price<br/>\$</b> | <b>Number</b> | <b>Weighted<br/>average<br/>exercise price<br/>\$</b> |
| <b>Options outstanding, beginning of period</b> | <b>619,381</b> | <b>5.26</b>   | 404,744       | 7.61  |
| Granted   | 154,182        | 3.53  | 124,482       | 2.73  |
| Exercised                                       | (4,123)        | 2.70  | -             | -   |
| Forfeited                                       | (21,250)       | 3.97  | (13,291)      | 5.06  |
| Expired   | (128,250)      | 9.15  | (10,000)      | 11.14   |
| <b>Options outstanding, end of period</b>       | <b>619,940</b> | <b>4.09</b>   | 505,935       | 6.41  |
| <b>Exercisable</b>                              | <b>493,448</b> | <b>4.47</b>   | 333,634       | 7.27  |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007

(unaudited)

**7. Capital stock (continued)**

All options granted were with exercise prices equal to the market price of the Company's shares at the date of grant. Compensation expense of \$408,009 (2006 - \$136,035) has been recognized for the first half of 2007 for stock options granted to employees and directors. The fair value of stock options at the grant date was estimated using the Black-Scholes option pricing model with the following assumptions:

|  | <b>2007</b>      | <b>2006</b> |
|--|------------------|-------------|
| Expected dividend                        | <b>Nil</b>       | Nil         |
| Expected volatility                      | <b>67% - 70%</b> | 68% - 69%   |
| Risk-free interest rate                  | <b>4% - 4.6%</b> | 4%          |
| Expected option life                     | <b>5-7 years</b> | 5 years     |
| Weighted average stock option fair value | <b>\$2.42</b>    | \$1.64      |

**Contributed surplus**

|   |                  |
|---|------------------|
|   | <b>\$</b>        |
| <b>Balance as at December 31, 2006</b>                                    | <b>7,920,211</b> |
| Options granted to employees and directors                                | 408,009          |
| Amount transferred to "Share capital" relating to stock options exercised | (6,660)          |
| <b>Balance as at June 30, 2007</b>  | <b>8,321,560</b> |

**8. Payments to former President and CEO**

Under the terms of an agreement dated April 18, 2007 between the Company and its former President and CEO, who left the Company on that date, he received a lump-sum payment of \$600,000 and 33,898 common shares of the Company with a market value at that date of \$100,000. In addition, under a consulting agreement entered into on the same date, the Company will pay an additional amount of up to \$100,000 over a 12-month period commencing on the above date.

Under the Company's Employee Share Purchase Loan Program, the former President and CEO received in 2000 a \$100,000 non-interest bearing loan to purchase 3,816 special warrants of the Company at \$26.20 each. The loan is collateralized by the underlying common shares of Ambrilia. The loan receivable was deducted from shareholders' equity. Any proceeds to be received as settlement of the loan receivable will be recorded as a capital transaction. By mutual agreement between the Company and the former President and CEO, the settlement of this loan will be deferred until a date to be determined by the Company, but which shall be not later than December 31, 2008. The Company has a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the loan, and also to pay to the former President and CEO an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the loan balance.

In the consolidated statements of operations, deficit and comprehensive income for the three months and six months periods ended June 30, 2007, the general and administrative expenses include a total of \$877,700 for the above items.