

# 2006

## QUARTERLY REPORT

SECOND QUARTER



*Our strength is innovation.  
Our commitment is to improving  
the quality of life.*



## LETTER TO SHAREHOLDERS

### Dear Fellow Shareholder,

As predicted in our year-end report of fiscal 2005, this fiscal year is proving to be a pivotal one for our Company. As we complete the second quarter of fiscal 2006, we can see substantial progress toward our key milestones for the year.

### Bladder Cancer Clinical Trial with MCC

The most significant recent event was the approval by the U.S. Food and Drug Administration (FDA) of our Investigational New Drug (IND) application for the first of two Phase III clinical trials using the Company's proprietary Mycobacterial Cell Wall-DNA Complex (MCC) for the treatment of bladder cancer. This was announced on February 6, 2006.

Approximately 142,000 patients in North America and Europe are newly-diagnosed with high-risk superficial bladder cancer each year. Approximately 96,000 of these are high-risk cases, of which 30%+/- are refractory to standard therapy.

In this first part of the Phase III program, 105 patients will be involved in an open-label study showing the efficacy of MCC as therapy in superficial bladder cancer refractory (unresponsive) to Bacillus Calmette-Guérin (BCG). BCG is a live, attenuated strain of *Mycobacterium bovis*, the current standard therapy for bladder cancer, but one that is often associated with treatment-limiting side effects. This Bioniche study will be conducted in North America. Patient enrolment will commence in the second quarter of calendar 2006. This clinical trial is expected to take between three and four years to complete.

The FDA is currently reviewing the IND for the second part of our Phase III program, in which approximately 600 patients will be involved in a randomized, double-blind, multi-centre study comparing MCC to BCG as first-line therapy in superficial bladder cancer at high risk of recurrence or progression. This study will take place in both North America and Europe. We are optimistic that we will receive the go-ahead on this second part of our Phase III program shortly. In approving part one, the FDA has responded positively to our data package, including results of previous human and laboratory animal studies; the mode of action of MCC against bladder cancer; its safety profile: the schedule of treatment; and how it is manufactured.

### Pharma Transaction Closed

Another significant recent event was the sale of Bioniche Pharma Group Ltd., our sterile injectable manufacturing business, to RoundTable Healthcare Partners, a U.S. private equity group from Lake Forest, Illinois.

With a combination of cash, debt assumption, equity in the business going forward and performance payments, this transaction has a potential value to Bioniche of approximately \$33 million U.S. (\$38.4 million Cdn.).

The closing of the sale results in the elimination of a significant portion of our consolidated debt. At the same time, royalties on sales of *Suplasyn*®, the Bioniche-developed proprietary product for the treatment of osteoarthritis of the knee and small joint, and earnouts (performance payments) will provide future cash flow that will be directed to core operations. Bioniche also retains an ongoing 10% ownership position in Pharma, thus taking part in its future growth.

### U.S. Financing Completed

On December 8, 2005, we closed a private financing of \$18.5 million U.S. — the Company's largest single financing — with Laurus Master Funds, a U.S.-based institutional investor. This financing included a \$7.5 million U.S. bridge loan, which has been repaid from proceeds of the Pharma sale. It also provided a \$4 million U.S. operating facility and a \$7 million U.S. secured convertible term loan, both three-year arrangements. This investment by Laurus Master Funds shows great confidence in our company and in our strategic direction by a well-known U.S. investor. At the same time, it has allowed us to obtain critical working capital for our operations without the dilution that would have been created by doing an equity financing at a low share price.

### Food Safety

Efficacy and safety studies have been completed to support a registration of our *E. coli* O157:H7 cattle vaccine in the United States. The data package is almost complete for the U.S. Department of Agriculture (USDA), and we expect to submit it for their

feedback imminently. The final study was completed in December — an animal safety study involving 900 cattle in three groups that were administered our vaccine and checked to ensure that there were no severe adverse reactions experienced by the animals. No such reactions were reported.

The Canadian Food Inspection Agency (CFIA) continues to require us to evaluate the safety of individuals administering the vaccine to cattle in the event of an accidental needle stick. Animal studies are being initiated.

We continue to plan for production scale-up at our Belleville, Ontario facility and will be prepared to launch the vaccine into the U.S. market with USDA approval later this year.

#### **Board Membership Changes**

The Company continues to move toward greater independence on its Board of Directors. To that end, Albert Beraldo and David Butts have each resigned from the Board. In addition, as a result of the Company having repaid the loan held by a consortium of Canadian investors, Nicholas Photiades of the Business Development Bank of Canada has resigned his Board seat. Each of these gentlemen made valuable contributions to the governance of Bioniche during their tenure. We sincerely appreciate their commitment and interest in the Company.

#### **Outlook for Remainder of Fiscal 2006**

At the mid-way point of our fiscal year, it is very satisfying to see the progress that we are making toward achieving our key milestones:

<b>Division</b>	<b>Event</b>	<b>Timing (calendar year)</b>
Human Health	Acceptance of Phase III/pivotal trial submission by U.S. FDA for MCC in bladder cancer	Q2, 2006
Human Health	Signing of a European marketing partnership agreement for MCC	Q2-Q3, 2006
Food Safety	Registration of <i>E. coli</i> O157:H7 cattle vaccine in U.S.	Q2-Q3, 2006
Human Health Oligonucleotides	Out-licensing to strategic partner	Q3-Q4, 2006

I fully expect our momentum to continue for the remainder of the year, and look forward to sharing news of our achievements in the months ahead. I am grateful for the support of our shareholders as the Company continues to evolve and mature.

Sincerely,



**Graeme McRae**  
President & CEO

## MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS FROM OPERATIONS

The following discussion and analysis is the responsibility of management. It should be read in conjunction with the accompanying interim consolidated financial statements and associated notes, as well as the audited financial statements and Management's Discussion and Analysis as published in the annual report for the fiscal year ending June 30, 2005. The discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. The Company's future results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed in "Risks and Uncertainties". All amounts are in Canadian dollars unless otherwise indicated.

The Company has continued to experience a challenge in its financial condition and liquidity during fiscal 2006. Further discussion is provided in the section "Liquidity, Financing, and Capital Resources".

### Overview

Bioniche is a research-based, technology-driven Canadian biopharmaceutical company that discovers, develops, manufactures, and markets proprietary products for Human and Animal Health markets worldwide. The fully-integrated Company employs 175 people and has three principal reporting divisions: Human Health, Animal Health, and Food Safety. Corporate headquarters are located in Belleville, Ontario, Canada with research, manufacturing, marketing/sales and distribution facilities in Belleville, Ontario; Montréal, Québec; Athens, Georgia; Pullman, Washington; and Armidale, Australia.

Bioniche has a presence in the global marketplace, as well as a portfolio of products and technologies in development that promise to have a profound impact on the converging world of Human and Animal Health. Bioniche has several areas of strategic focus, including the development of effective therapies for bladder cancer and potentially other cancers; a cattle vaccine to help prevent *E. coli* O157:H7 contamination of food, water and the environment; technologies to improve livestock reproduction; and technologies that could replace the use of antibiotics in livestock.

A significant portion of the Company's time and resources in research and development is currently focused on the Human Health segment, where the Company's proprietary cancer therapy is nearing a Phase III/pivotal clinical trial. In Animal Health and Food Safety, the research and development focus has been primarily on the development of the *E. coli* O157:H7 cattle vaccine. Thus, activities on other projects in these segments have been curtailed pending the completion of the *E. coli* O157:H7 project.

The structure of the Company is such that its key research and development projects are supported by a revenue-generating business: the Animal Health Division consistently generates positive earnings before interest, taxes, depreciation and amortization (EBITDA) before research and development. The Human Health Division and the Food Safety Division require cash for their operations. The Company's cash requirements are met by financings through the issuance of shares and/or debt and by the cash flow generated by the Animal Health Division.

### HIGHLIGHTS FOR THE SECOND QUARTER OF FISCAL 2006

#### Pharma Sale Closed on February 1, 2006

The most significant recent event occurred subsequent to the end of the second quarter: the closing of the sale of Bioniche Pharma Group Ltd., the Company's sterile injectable manufacturing business, to RoundTable Healthcare Partners, a U.S. private equity group from Lake Forest, Illinois.

With a combination of cash, debt assumption, equity in the business going forward and performance payments, this transaction recognizes the value to Bioniche of up to \$33 million U.S. (\$38.4 million Cdn.). The impact of this transaction on the balance sheet is shown below under the section, "Subsequent Events and Outlook".

The sale results in the elimination of a significant portion of the Company's consolidated debt. At the same time, future payments regarding *Suplasyn*®, the Bioniche-developed proprietary product for the treatment of osteoarthritis of the knee and small joint, and earn outs (performance payments) will provide future cash flow that is anticipated to be directed to core operations. Bioniche also receives a 10% ownership position in the new company which holds the shares in Pharma, thus retaining an interest in its future growth.

### U.S. Financing Completed

On December 8, 2005, Bioniche closed a private financing of \$18.5 million U.S. with Laurus Master Funds, a U.S.-based institutional investor. This financing included a \$7.5 million U.S. bridge loan, which has been repaid from proceeds of the Pharma sale. It also included a \$4 million U.S. operating facility and a \$7 million U.S. secured convertible term loan, both three-year arrangements. More details on the impact of this transaction is shown below in the section, "Financing Activities Closed During the Quarter" and under note [6] of the financial statements.

## RESULTS OF OPERATIONS FOR THE PERIOD ENDED DECEMBER 31, 2005 COMPARED TO PERIOD ENDED DECEMBER 31, 2004

<b>CONSOLIDATED RESULTS AT A GLANCE</b>				
	2006	2006	2005 restated	2005 restated
	Q2	YTD	Q2	YTD
(expressed in millions of Canadian dollars)	\$	\$	\$	\$
Revenue	7.4	13.7	6.8	13.8
Gross profit	4.7	8.3	3.7	7.4
Gross margins overall	63%	61%	55%	54%
<b>Expenses</b>				
Administration	1.4	2.4	0.9	1.7
Marketing and selling	1.7	3.2	2.0	3.5
Quality assurance	0.3	0.5	0.2	0.5
Share ownership and bonus	0.1	0.2	0.2	0.4
Total Expenses	3.5	6.3	3.3	6.1
<b>EBITDA* before research and development and other items</b>	<b>1.2</b>	<b>2.0</b>	<b>0.4</b>	<b>1.3</b>
Research and development expenses, net	2.8	5.6	2.5	5.2
Interest, taxes, depreciation, amortization and others**	4.0	5.5	1.0	2.2
Loss from continuing operations	(5.6)	(9.1)	(3.1)	(6.1)
<b>Income (loss) from discontinued operations</b>	<b>(0.1)</b>	<b>0.1</b>	<b>(1.8)</b>	<b>(3.5)</b>
Net loss	(5.7)	(9.0)	(4.9)	(9.6)
Basic and diluted net income (loss) per share				
Continuing operations	(0.15)	(0.25)	(0.08)	(0.17)
Discontinued operations	0.00	0.00	(0.05)	(0.10)
Total net loss per share	(0.15)	(0.25)	(0.13)	(0.27)

\*\* Other includes the cost of Debt refinancing

\* EBITDA means earnings before interest, taxes, depreciation, and amortization.

For more information, please refer to the section, "Non-GAAP & Other Measures" below

The Company's consolidated revenues for the second quarter of fiscal 2006 show an improvement over the same period last year. Both Human Health and Animal Health segments showed improvements through increased focus on proprietary products following a review of the Company's product offerings.

The Company's overall gross profit improved to 63% this quarter, from 55% reported in the same period last year, reflecting the Company's increased focus on branded proprietary products, which have higher margins than non-branded products. Improved margins contributed to an increase in EBITDA before research and development.

The Animal Health Division consistently generates positive EBITDA before research and development. The Human Health Division and the Food Safety Division require operating cash. Bioniche Life Sciences' cash requirements are met by additional

financing through the issuance of shares and/or debt and by the cash flow generated by the Animal Health Division. Cash and cash equivalents were \$2.3 million as at December 31, 2005, as compared to \$3.5 million at the end of the Company's last fiscal year (June 30, 2005).

During the quarter, the Company incurred a one-time cost of \$2.5 million associated with refinancing the Company's debt. This accounts for the increased loss from \$3.3 million recorded in the first quarter to \$5.7 million recorded this quarter for a total loss of \$9.0 million this year to date. For the six-month period ending December 31, 2005 the Company reported a total loss of \$9.0 million as compared to \$ 9.6 million recorded in the same period last year. Last year's results included a loss on discontinued operations of \$3.5 million as compared to a profit of \$0.1 million this year. This improvement in discontinued operations reflects the introduction of *Sotradecol* injectable.

## RESULTS BY BUSINESS SEGMENT

### Bioniche Life Sciences Inc.

Human Health

Food Safety

Animal Health

Bioniche Life Sciences Inc. operates three global business segments: Human Health, Animal Health, and Food Safety. Bioniche Therapeutics, as referenced in prior reports, is the Human Health segment of the Company. The financial performance of each segment is presented below:

	Human Health		Animal Health		Food Safety		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
Current Quarter December (expressed in thousands of Canadian dollars)								
Sales	1,286	1,171	6,136	5,643	—	—	7,422	6,814
Cost of sales	354	351	2,378	2,714	—	—	2,732	3,065
Expenses	652	477	2,871	2,836	—	—	3,523	3,313
EBITDA before research and development	280	343	887	93	—	—	1,167	436
Net research and development expenses	1,813	1,708	693	568	273	240	2,779	2,516
Others	794	674	401	312	13	6	1,208	992
Foreign exchange							261	10
Debt refinancing							2,494	—
Segment income (loss) before taxes and discontinued operations	(2,327)	(2,039)	(207)	(787)	(286)	(246)	(5,575)	(3,082)

	Human Health		Animal Health		Food Safety		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
Year to Date December (expressed in thousands of Canadian dollars)								
Sales	1,972	2,320	11,764	11,496	—	—	13,736	13,816
Cost of sales	504	735	4,908	5,731	—	—	5,412	6,466
Expenses	1,276	855	5,098	5,226	—	—	6,374	6,081
EBITDA before research and development	192	730	1,758	539	—	—	1,950	1,269
Net research and development expenses	3,735	3,289	1,355	1,322	586	546	5,676	5,157
Others	1,574	1,344	816	616	14	11	2,404	1,971
Foreign exchange							494	209
Debt refinancing							2,494	—
Segment income (loss) before taxes and discontinued operations	(5,117)	(3,903)	(413)	(1,399)	(600)	(557)	(9,118)	(6,068)

### Human Health Segment (Bioniche Therapeutics)

Bioniche Therapeutics is responsible for scientific discovery, pre-clinical research, clinical development, regulatory submissions, and commercialization of therapeutic products for use in human medicine.

Using three platform technologies: Mycobacterial Cell Wall-DNA Complex (MCC), hyaluronan, and oligonucleotides, the Company's research and development initiatives focus on the areas of cancer, immunomodulation, and inflammation.

Bioniche Therapeutics' product development candidates include MCC for the treatment of bladder cancer and a combination of MCC and hyaluronan for the treatment of prostate cancer. Bioniche Therapeutics has a commercialized human health product — *Cystistat*® — for the treatment of cystitis, a group of painful and debilitating bladder conditions.

Sales of *Cystistat* for the second quarter of fiscal 2006 were \$1.1 million compared to \$1.0 million recorded in the same period last year. For the six-month period ending December 31, 2005, sales totaled \$1.5 million as compared to \$1.9 million recorded in the same period last year, a decrease of \$0.4 million. The decrease can be attributed to competition from reimbursed products in the European market. This is partially offset by an increase in licensing revenue of \$0.2 million recognized in the current period.

Marketing and overhead expenses associated with the management of this segment increased on a year-to-date basis as compared to the same period last year, reflecting added support required to develop product sales. Management is currently preparing submissions seeking reimbursement of this product in Europe. Competitive products in Germany and France were successful in securing drug plan reimbursement late last year, which has resulted in a competitive advantage over *Cystistat* and has negatively impacted sales year-to-date. Management is pursuing similar reimbursement for *Cystistat* and is confident that this will be secured.

For the six-month period ending December 31, 2005, the Company's gross research and development costs increased by \$0.2 million, or 5%, over the same period last year. These expenses relate to the Company's preparatory work leading to the submission of the Phase III/pivotal clinical trial protocol using MCC for bladder cancer (trademarked *Urocidin*) to the U.S. Food and Drug Administration (FDA) and the European Medicines Agency (EMA).

The segment loss for Human Health for the 3 months ending December 31, 2005 totaled \$2.3 million, this compares to \$2.0 million reported in the same period last year. The segment loss for Human Health during the first six months ending December 31, 2005 totaled \$5.1 million, this compares to \$3.9 million reported in the same period last year. This represents an increase of \$1.2 million, or 31%, as compared to the same period last year. This reflects increased costs related to marketing, research and development and overheads associated with supporting the research operations

### Animal Health Segment

Bioniche Animal Health was established in 1979 to develop vaccines and other pharmaceutical products for the preventive health management of animal diseases. Now the largest Canadian-owned animal health company, Bioniche Animal Health has a large product portfolio that can be categorized in three major groups: reproduction and embryo transfer; immunology; and vaccines. *Folltropin*®-V, the Company's lead product, is a top-selling follicle-stimulating hormone (FSH). *Folltropin*-V is used in the embryo transfer industry to induce super-ovulation in cattle. The Company's research and development program has provided veterinarians and animal producers with a wide range of animal vaccines with proven safety profiles for use in cattle, swine, equine, and companion animals. The research and development resources are currently focused on completing the necessary development work in food safety to obtain registration for the *E. coli* O157:H7 cattle vaccine. A number of other projects are pending.

Animal Health sales were \$6.1 million for the second quarter of fiscal 2006 as compared to \$5.6 million recorded in the same period last year. This increase of \$0.5 million, or 9%, reflects increased sales in all markets. Animal Health sales were \$11.8 million for the six months ending December 31, 2005 as compared to \$11.5 million in the same period last year. Gross profit totaled \$6.9 million, or 58%, for the six-month period ending December 31, 2005 as compared to \$5.8 million or 50% recorded in the same period last year. This reflects a shift to proprietary products with higher margins.

Overhead expenses in the Animal Health segment continued to decrease in the second quarter of fiscal 2006 as compared to the same period last year, contributing to positive EBITDA before research and development of \$0.8 million over the same quarter

last year. For the six-month period ending December 31, 2005, EBITDA before research and development totaled \$1.8 million compared to \$0.5 million reported in the same period last year.

The research and development costs in this segment remained stable. They related, for the most part, to the registration of reproductive products in other jurisdictions.

The loss for the Animal Health segment for the six-month period ending December 31, 2005 totaled \$0.4 million compared to a loss of \$1.4 million recorded in the same period last year. This represents an improvement of \$1.0 million. Management anticipates continued successful results.

The results for the last eight quarters below demonstrate the seasonality effect in the Animal Health business. The second half of the year, from January to June, normally generates stronger revenues from Animal Health reproductive products due to the timing of the breeding season.

### LAST EIGHT (8) QUARTERS CONSOLIDATED RESULTS AT A GLANCE

(expressed in millions of Canadian dollars)	2006		2005				2004	
	\$	\$	\$	\$	\$	\$	\$	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	7.4	6.3	8.8	7.7	6.8	7.0	9.4	7.8
Income (loss) before research & development and other items	(2.8)	(0.7)	0.5	(0.4)	(0.5)	(0.2)	0.4	1.4
Loss from continuing operations	(5.6)	(3.5)	(2.9)	(3.6)	(3.0)	(3.0)	(2.9)	(1.7)
Income (loss) from discontinued operations	(0.1)	0.2	0.2	0.3	(1.9)	(1.7)	1.5	(0.4)
Net loss	(5.7)	(3.3)	(2.7)	(3.3)	(4.9)	(4.7)	(1.4)	(2.1)
Basic net income (loss) per share								
Continuing operations	(0.15)	(0.10)	(0.08)	(0.10)	(0.08)	(0.09)	(0.09)	(0.05)
Discontinued operations	—	—	—	0.01	(0.05)	(0.05)	0.05	(0.01)
Total basic net loss per share	(0.15)	(0.10)	(0.08)	(0.09)	(0.13)	(0.14)	(0.04)	(0.06)
Diluted net income (loss) per share								
Continuing operations	(0.15)	(0.10)	(0.08)	(0.10)	(0.09)	(0.08)	(0.09)	(0.05)
Discontinued operations	—	—	—	0.01	(0.05)	(0.04)	0.04	(0.01)
Total diluted net loss per share	(0.15)	(0.10)	(0.08)	(0.09)	(0.14)	(0.12)	(0.05)	(0.06)

### Food Safety Segment

Bioniche Food Safety is responsible for researching, developing, manufacturing, and marketing vaccines to help improve the safety of food and water supplies worldwide.

The leading Food Safety initiative is the development and commercialization of a cattle vaccine for the prevention of the spread of *E. coli* O157:H7 bacteria, a deadly, toxin-producing strain that can result in long-term kidney damage, and sometimes death, in humans. This vaccine is designed to reduce the colonization of *E. coli* O157:H7 bacteria in the cattle gut and reduce the shed of the bacteria in the manure, thereby reducing contamination into the environment, ground water, cattle processing plants, and limiting subsequent human exposure.

Bioniche Food Safety is currently researching other products in the food and water safety field and is working with the Vaccine and Infectious Diseases Organization (VIDO) at the University of Saskatchewan to develop these.

This segment of the Company's business does not yet have a commercialized product. Therefore, the loss for the Food Safety segment during the second quarter of fiscal 2006 remained at \$0.3 million, similar to the same period last year. This can be associated entirely with the ongoing research and development related to the *E. coli* O157:H7 cattle vaccine.

### EXPENSES OTHER THAN RESEARCH & DEVELOPMENT

Expenses other than research and development were \$7.5 million for the quarter ending December 31, 2005. This represents an increase of \$3.2 million, or 74%, as compared to the same period last year. Included in this amount is a cost of \$2.5 million incurred to refinance the Company's debt.

Expenses other than research and development were \$11.8 million for the six-month period ending December 31, 2005. This represents an increase of \$3.5 million, or 42%, as compared to the same period last year. In addition to the debt refinancing cost of \$2.5 million, legal and professional fees have increased by \$0.6 million and interest on a capital lease of \$0.1 million to a company controlled by the CEO and Director of Bioniche, as compared to the same period last year.

Overall administration, selling and marketing and quality assurance expenses represent 44% of sales on a year-to-date basis. This is an increase of 3% as compared to the same six-month period ending December 31, 2005 and as depicted in the following chart. With expenses forecast to remain flat for the remainder of fiscal year 2006, it is anticipated that these expenses as a percentage of sales will decline over the balance of the year due to seasonality of sales. Typically, sales levels are higher in the last six months of the fiscal year.

### EXPENSES OTHER THAN RESEARCH & DEVELOPMENT (expressed in millions of Canadian dollars)

	2006			2005 restated		
	Q2 \$	YTD		Q2 \$	YTD	
		\$	%		\$	%
<b>Revenue</b>	7.4	13.7	100%	6.8	13.8	100%
<b>Expenses</b>						
Administration	1.4	2.4	17%	0.9	1.7	13%
Selling and marketing	1.7	3.2	23%	2.0	3.5	25%
Quality assurance	0.3	0.5	4%	0.2	0.5	4%
Subtotal	3.4	6.1	44%	3.1	5.7	42%
<b>Non-cash items</b>						
Share ownership and bonus	0.1	0.2	2%	0.2	0.4	3%
Amortization	0.8	1.4	10%	0.5	1.0	7%
Subtotal	0.9	1.6	12%	0.7	1.4	10%
<b>Other items</b>						
Interest	0.5	1.1	8%	0.5	1.0	7%
Foreign exchange	0.2	0.5	4%	—	0.2	1%
Debt refinancing	2.5	2.5	18%	—	—	0%
Subtotal	3.2	4.1	30%	0.5	1.2	8%
<b>Total</b>	<b>7.5</b>	<b>11.8</b>	<b>86%</b>	<b>4.3</b>	<b>8.3</b>	<b>60%</b>

### EBITDA before Research and Development

EBITDA before research and development in the second quarter totaled \$1.2 million. This compares to \$0.4 million recorded in the same period last year. For the six months ending December 31, 2005, EBITDA totaled \$2.0 million, as compared to \$1.3 million recorded in the same period last year. The increased gross profit margins have contributed to the increase in EBITDA over last year's level.

### Research and Development

Gross research and development expenses in the second quarter totaled \$3.2 million as compared to \$2.9 million reported in the same period last year. For the six-month period ending December 31, 2005, gross research and development expenses totaled \$6.2 million. This represents a slight increase of \$0.4 million, or 7.0%, over the same period last year.

During this quarter, field trials to support the efficacy of the *E. coli* O157:H7 cattle vaccine continued. The balance represents the costs associated with the Company's research laboratories located in Montréal and Belleville, as well as the cost to operate the Good Manufacturing Practice (GMP) pilot facility in Montréal that produces MCC for bladder cancer (*Urocidin*).

The Company has been working toward finalizing the Investigational New Drug (IND) submission for the proposed Phase III/pivotal clinical trial with MCC for bladder cancer. Following approval of the IND by the U.S. Food and Drug Administration (FDA), and approval of the Clinical Trial Applications (CTAs) by Health Canada and various European Regulatory authorities, the Company anticipates a significant increase in research and development expenditures to launch the multi-site, international trial.

**GROSS RESEARCH & DEVELOPMENT**  
(expressed in millions of Canadian dollars)

Key Areas	2006			2005		
	Q2	YTD		Q2	YTD	
	\$	\$	%	\$	\$	%
Human Health	2.2	4.1	66.00%	2.0	3.8	66.00%
Animal Health	0.7	1.4	23.00%	0.6	1.4	24.00%
Food Safety	0.3	0.7	11.00%	0.3	0.6	10.00%
<b>Total</b>	<b>3.2</b>	<b>6.2</b>	<b>100.00%</b>	<b>2.9</b>	<b>5.8</b>	<b>100.00%</b>

**Discontinued Operations — Bioniche Pharma Group Limited**

Bioniche Pharma Group was the Company's specialty pharmaceutical segment, involved primarily in the development, manufacturing, and marketing of sterile injectable products. Bioniche Pharma sells a number of non-branded products in the U.S. market for which it has received approved Abbreviated New Drug Applications (ANDAs). It also sells the Bioniche branded product, *Suplasyn*<sup>®</sup>, in 30 countries globally. Bioniche Pharma products are sold to both the primary care and hospital markets in the U.S., Canada, and Europe.

As previously disclosed, Bioniche Life Sciences has sold its shares of Bioniche Pharma Group, representing approximately 65% (fully diluted) to RoundTable Healthcare Partners, a U.S. healthcare focused private equity group. As part of the sale, Bioniche Life Sciences now owns a 10% interest in the new company, which now holds the shares of the Pharma Group.

Bioniche Pharma revenue for the six-month period ending December 31, 2005 totaled \$10.9 million. This is an increase of \$3.9 million, or 56%, as compared to the same period last year. This can be attributed to the launch of *Sotradecol* Injectable, which recorded sales of \$1.7 million. The balance of sales growth occurred with the Company's osteoarthritis product, *Suplasyn*, in Germany.

**INCOME (LOSS) FROM DISCONTINUED OPERATIONS**  
(expressed in millions of Canadian dollars)

For the three and six months ended December 31	2006		2005	
	Q2	YTD	Q2	YTD
<b>Revenues</b>	5.4	10.9	3.7	7.0
Cost of sales	2.3	4.3	1.7	3.1
Gross profit	3.1	6.6	2.0	3.9
Expenses	2.9	5.0	3.1	5.8
EBITDA before R&D	0.2	1.6	(1.1)	(1.9)
Net research & development	0.4	0.7	0.2	0.4
Interest, amortization, taxes & other	(0.1)	0.8	0.5	1.2
<b>Income (loss)</b>	<b>(0.1)</b>	<b>0.1</b>	<b>(1.8)</b>	<b>(3.5)</b>

**CASH FLOW FROM (USED IN) DISCONTINUED OPERATIONS**  
(expressed in millions of Canadian dollars)

For the three and six months ended December 31	2006		2005	
	Q2	YTD	Q2	YTD
Operating activities	2.1	3.7	(1.6)	0.6
Investing activities	(1.4)	(2.1)	(5.1)	(8.3)
Financing activities	(0.4)	(0.8)	6.6	8.1
Effect of foreign currency translation	(0.2)	(0.5)	0.2	0.0
<b>Net cash provided</b>	<b>0.1</b>	<b>0.3</b>	<b>0.1</b>	<b>0.4</b>

Net income of \$0.1 million was recorded in the six-month period ending December 31, 2005, compared to a loss of \$3.5 million recorded in the same period last year. This increased profitability directly reflects Pharma's increased sales.

**Liquidity, Financing, and Capital Resources**

The Company's working capital ratio decreased at December 31, 2005 from June 30, 2005, as a result of the bridge financing with Laurus Master Funds to pay out a previously recorded long term debt (see "Financing Activities Closed During the Quarter"). This bridge loan was put in place to allow the Company to complete the sale of Bioniche Pharma Group to RoundTable Healthcare Partners (see "Subsequent Events and Outlook" below). The bridge loan of \$8.7 million Cdn. is presented as a current liability at the end of December and, subsequently, was repaid on February 1, 2006, upon completion of the Pharma Group sale.

Accounts receivable decreased to \$6.3 million at December 31, 2005 from \$7.3 million at June 30, 2005 as a result of the Company collecting accumulated claims from Technology Partnerships Canada (TPC). Accounts payable increased to \$7.8 million at December 31, 2005 from \$7.0 million at June 30, 2005. The Company actively managed working capital while refinancing its debt to preserve cash.

The Company has incurred significant losses and cash outflows from operations to date. At December 31, 2005, the Company's committed cash obligations and expected level of expenses for the remainder of the fiscal year exceed the committed sources of funds and the Company's cash balances on hand. After receipt of the proceeds of the sale of Bioniche Pharma Group, as outlined in note 7, the Company will require additional financial resources in order to support the commercialization of its core technologies currently under development. The ability of the Company to continue as a going concern is dependent upon the continued support of its lenders and its ability to establish the technological feasibility of its products, bring its products to market, obtain regulatory approvals, achieve future profitable operations, and to obtain additional financing. The outcome of these matters is dependent on a number of items outside the Company's control. If the Company is unable to obtain adequate financing, management will be required to curtail its operations. As a result, there is significant uncertainty as to whether the Company will have the ability to continue as a going concern.

**Financing Activities Closed During the Quarter**

As previously noted, on December 8, 2005, the Company completed a private placement with Laurus Master Funds, whereby three financial instruments were negotiated: a revolving credit facility; a bridge facility; and a convertible term note. More details are presented under note 6 but the highlights of this financing are as follows:

**Revolving Credit Facility**

- A three-year, \$4 million U.S. (\$4.7 million Cdn.) revolving credit facility, based on 90% of eligible accounts receivable and 35% of eligible North American inventory, capped at \$2.5 million U.S.
- The principal may be paid in cash and/or shares.
- As at December 31, 2005, \$3.5 million U.S. (\$4.1 million Cdn.) has been drawn on this facility.

**Bridge Facility**

- A four-month, \$7.5 million U.S. (\$8.7 million Cdn.) bridge loan to be repaid from the proceeds of the sale of the Bioniche Pharma Group. Interest is payable monthly in cash at the greater of 6.5% or the Wall Street Journal (WSJ) prime rate plus 3%, for the four-month period.
- As at December 31, 2005, \$7.5 million U.S. (\$8.7 million Cdn.) had been drawn on this facility.
- The Company repaid this loan on February 1, 2006, following completion of the sale of the Pharma Group.

**Convertible Term Note**

- A three-year, \$7.0 million U.S. (\$8.2 million Cdn.) convertible term note, repayable in equal monthly installments making up 20% in the first year, 20% in the second year, and 60% in the third year, except with regard to the first two payments, which have been deferred to the final payout of the note.
- The accounting presentation used conforms with CICA 3860 where the fair value of the holder's conversion option, estimated at \$1.0 million Cdn. was reported as Other paid-in capital under "Shareholders' Equity". The remainder of the debt (\$7.1 million Cdn.) is shown as \$1.4 million Cdn. current and \$5.7 million Cdn. long-term senior debt.
- The monthly installments may be paid in Bioniche shares if certain thresholds and conditions are met. The fixed conversion price is \$0.88 per share on 50% of the principal amount of the note and \$1.05 on the balance. Interest is payable monthly in cash, calculated on the outstanding principal amount at the greater of 6.5% or the WSJ prime plus 2%, decreasing based on increases in the share price.
- The Company has the right to prepay the note, on certain conditions. Alternatively, the holder may convert the note, in whole or in part, into shares of common stock at any time upon one business day's prior written notice.

As part of the new loan, the Company issued to Laurus Master Funds five-year warrants to purchase 800,000 shares of common stock at \$1.10 per share. The fair value of the warrants (determined using the Black-Scholes model) of \$0.2 million has been included in deferred financing costs. Total financing fees incurred, including the fair value of the warrants, were \$1.5 million Cdn.

The proceeds from the private financing have been used to discharge all outstanding balances of \$2.4 million with the Royal Bank of Canada and the Business Development Bank of Canada, as well as the debenture of \$13.5 million held by a syndicate of Canadian institutions.

In addition to the principal owing on the debenture, a make-whole payment of \$1.8 million was made, of which \$0.6 million was settled in shares and \$1.2 million in cash. All unamortized deferred financing costs related to these loans, totaling \$0.6 million, were written off and included in the debt refinancing cost. All collateral previously held by these parties has been released.

As part of the transaction between Bioniche and Laurus Master Funds, Laurus has agreed that it will not, and has not, engaged in short sales of the Company's common shares including, without limitation, by hedging or derivatives, as long as the loans remain outstanding. Laurus is entitled to convert repayments into and sell the Company's common shares on a continuous basis.

**Subsequent Events and Outlook**

On February 1, 2006, the Company closed the sale of Bioniche Pharma Group Limited, its sterile injectibles manufacturing subsidiary based in County Galway, Ireland, to RoundTable Healthcare Partners, a U.S. healthcare focused private equity group based in Lake Forest, Illinois.

With a combination of cash, debt assumption, equity in the business going forward and performance payments, this transaction has a potential value to Bioniche of approximately \$33 million U.S. (\$38.4 million Cdn.). Upon closing of this transaction, the Company repaid its \$7.5 million U.S. bridge loan.

The balance of the proceeds will be applied to pay off loans and to provide working capital for the Company's areas of strategic focus.

Management expects the balance sheet to improve significantly post-closing by the recording of a gain estimated at approximately \$9.1 million, the reduction of its total liabilities by approximately 65%, and an improvement in its available cash in the short-term.

It is important to note that future considerations amounting to a possible total of \$20.0 million Cdn. are not recorded on closing, but will be recognized as income when earned by the Company. These future considerations consist of the following:

- a) Up to a maximum of \$11.6 million U.S. (\$13.2 million Cdn), over the next four years based on the EBITDA performance of the Pharma Group business.
- b) 5.0 million Euro (\$6.8 million Cdn.) over four years related to payments for *Suplasyn*® based upon future sales target being met.

After payment of its loans outstanding and cost to complete the transaction, the Company will retain \$4.3 million towards working capital requirements.

The unaudited pro forma balance sheet below, using the December 31, 2005 figures, reflects the potential impact as if the transaction had been closed on December 31, 2005.

<b>ASSETS</b>	Actual	Net impact and references of assumptions		Pro Forma
<i>Current</i>				
Cash and other current assets	16.2	4.3	a	20.5
<i>Discontinued operations</i>	<u>10.8</u>	(10.8)	b	<u>0.0</u>
	<u>27.0</u>			<u>20.5</u>
<i>Long-term</i>				
Capital assets & other Long Term assets	25.1	1.5	c	26.6
<i>Discontinued operations</i>	<u>29.6</u>	(29.6)	b	<u>0.0</u>
	<u>81.7</u>			<u>47.1</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
<i>Current</i>				
Accounts payable and other current liabilities	11.3	(1.5)	d	9.8
Current portion of Senior Long Term debt	14.4	(8.7)	e	5.7
<i>Discontinued operations</i>	<u>16.5</u>	(16.5)	b	<u>0.0</u>
	<u>42.2</u>			<u>15.5</u>
<i>Long-term</i>				
Senior and other Long Term liabilities	7.5			7.5
<i>Discontinued operations</i>	<u>16.6</u>	(16.6)	b	<u>0.0</u>
	<u>66.3</u>			<u>23.0</u>
<i>Shareholders' equity</i>	15.4	8.7	f	24.1
	<u>81.7</u>			<u>47.1</u>

The assumptions leading to this pro forma balance sheet are as follows:

- a. The net cash of \$4.3 million Cdn. at closing consists of \$13.25 million U.S. received from the purchaser (RoundTable Healthcare Partners) adjusted by repayment of \$7.5 million U.S. to the bridge lender (Laurus Master Funds) and less the repayment of loans and transaction costs of \$2.1 million Cdn..
- b. All related Bioniche Pharma Group ("Discontinued Operations") assets and liabilities are to be removed from the balance sheet post-closing. These amounts are still subject to the recording of January activities.

- c. Long-term assets are impacted by the recording of the 10% investment in Bioniche Pharma Group valued at approximately \$1.5 million Cdn.
- d. As part of the closing, the Company repaid payables amounting to \$1.5 million. This is related to products manufactured by the Pharma Group that were being sold by the Animal and Human Health business segments. As part of the transaction, the Company will continue to use the Pharma Group as its principle manufacturer for certain key products.
- e. As part of the closing, the Company repaid the bridge loan to Laurus Master Funds of \$8.7 million.
- f. A net gain on disposal of \$9.1 million, less the amount included in the cumulative translation amount of \$0.4 million related to the Pharma Group.

This pro forma balance sheet contains information that has not been reviewed. Any material differences will be reported in the next quarterly financial statements for the period ending March 31, 2006.

### **OUTSTANDING SHARE DATA**

#### **Common Shares**

The Company has total common shares outstanding at February 6, 2006 of 38,945,480. In addition, the Company has 3,506,250 outstanding warrants and 3,703,501 outstanding options, exchangeable for one common share upon exercise. Outstanding conversion rights on convertible term note are exchangeable for approximately 8,537,000 common shares and preferred shares Series II with conversion rights exchangeable for 8,910,000 common shares. The Company also has a commitment to issue approximately two million warrants.

### **NON-GAAP AND OTHER MEASURES**

The following measures included in the report do not have a standardized meaning under Canadian Generally Accepted Accounting Principles (GAAP) and, therefore, are unlikely to be comparable to similar measures presented by other companies:

#### **EBITDA**

"EBITDA" means Earnings Before Interest, Taxes, Depreciation, and Amortization. The Company considers EBITDA to be an effective measure of each segment's contribution to the Company on an operational basis. It is management's view that this measure is used by analysts and shareholders to evaluate the Company's operations.

#### **Burn Rate**

"Burn Rate" means cash flow used in operations. This information can be found in the Consolidated Statements of Cash Flows, under Operating Activities. It shows the cash flow used in operations (before change in non-cash working capital balances related to operations).

### **RISKS AND UNCERTAINTIES**

#### **Early Stage Development**

Several of the Company's products or processes are at an early stage of development. Significant additional investment in Research and Development and clinical trials of such product and process candidates is required prior to commercialization. A commitment of substantial time and resources is required to conduct research and clinical trials if the Company is to complete the development of any product or process. It is not known whether any of these product or process candidates will meet applicable health regulatory standards and obtain required regulatory approvals, whether such products or processes can be produced in commercial quantities at reasonable costs and be successfully marketed, or if the Company's investment in any such product or process candidate will be recovered through sales or royalties.

**Manufacturing Facilities**

The Company relies on having properly validated, fully functioning, and sufficiently sized manufacturing facilities in which to produce its products for market. Should systems fail, or a disaster strike, the ability to produce products would be negatively affected which, in turn, would affect revenue generation. The Company does not currently have backup manufacturing capacity for some of its key products. As a result, it would be forced to turn to external manufacturers should an unexpected event as described above occur.

**Government Regulations**

The manufacture and sale of animal and human therapeutic products is governed by numerous statutes and regulations in the United States, Canada, Ireland, and other countries where the Company intends to market its products. The subject matter of such legislation includes approval of manufacturing facilities, controlled research and testing procedures, review and approval of manufacturing, pre-clinical, and clinical data prior to marketing approval, adherence to GMP during production and storage, and regulation of marketing activities, notably advertising and labeling. The Company's products and processes will require significant development, pre-clinical and clinical testing, and investment of significant funds prior to their commercialization. There can be no assurance that any such products will actually be developed. The process of completing clinical testing and obtaining required approvals is likely to take several years and require the expenditure of substantial resources. Furthermore, there can be no assurance that the regulators will not require modification to submissions, which may result in delays or failure to obtain regulatory approval. Any delay or failure to obtain regulatory approvals could adversely affect the ability of the Company to utilize its technology, thereby, adversely affecting operations. Further, there can be no assurance that the Company's product candidates will prove to be safe and effective in clinical trials, nor that they will receive the requisite regulatory approval. Foreign markets, other than the United States and Canada, impose similar restrictions.

**Key Personnel**

The Company's success is also dependent upon its ability to attract and retain a highly-qualified work force, and to establish and maintain close relations with research centres. Competition is intense and the Company's success will depend, to a great extent, on its senior executives, scientific staff, and collaborators. The loss of key personnel could compromise the rhythm and success of product development.

**Cash Flow & Financial Resources**

The current burn rate of \$1.0 million per month on average is expected to remain unchanged during the remainder of the fiscal year 2006. As well, certain amounts of the Company's long-term debt have been reclassified as current. In the coming year, the Company will require cash to fund future operations. The Company is dependent upon the future support of its lenders regarding compliance with financial covenants and its ability to obtain additional financing.

The Company believes that it will be able to obtain long-term capital to support its corporate objectives. However, it is impossible to guarantee the availability of additional financial resources or that these will be available under acceptable conditions. In the event that there is an inability to raise sufficient capital, the Company will be required to rationalize its spending programs.

**Foreign Exchange Risk**

The Company is also exposed to currency risks as a result of the export of products manufactured in Canada and Europe, the majority of which are denominated in U.S. dollars.

**Volatility of Share Prices**

Share prices are subject to change because of numerous different factors related to Company activity, including reports of new information, changes in the Company's financial situation, the sale of shares in the market, the Company's failure to obtain results in line with the expectations of analysts, an announcement by the Company or any of its competitors concerning technological innovation, etc. During the past few years, shares of Bioniche Life Sciences Inc., other biopharmaceutical companies, and the investment market in general have been subjected to extreme fluctuations that were unrelated to the operational results of the companies affected. There is no guarantee that the market price of Company shares will be protected from any such fluctuations in the future.

**Intellectual Property Infringement Claims**

Third parties may claim that we infringe upon their intellectual property. Any such claims, with or without merit, could materially harm our business and operating results.

**FORWARD-LOOKING STATEMENTS**

This discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events predicted in this document to differ materially from actual results or events. No assurance can be given that results, performance or achievement expressed in, or implied by, forward-looking statements within this disclosure will occur or, if they do, that any benefit may be derived from them.

**OTHER INFORMATION ABOUT THE COMPANY**

Additional information relating to the Company, including the Annual Information Form (AIF), is available on SEDAR at [www.sedar.com](http://www.sedar.com).



**Patrick Montpetit, CA**  
Vice-President, Finance and Chief Financial Officer  
February 6, 2006

**Bioniche Life Sciences Inc.**

Amalgamated under the laws of Ontario  
(Unaudited)

**CONSOLIDATED BALANCE SHEETS**

(see Note 1)

	As at Dec 31 2005 \$	As at June 30 2005 \$
<b>ASSETS</b>		
<b>Current</b>		
Cash	2,295,621	3,527,408
Accounts receivable	6,261,052	7,281,010
Inventories	6,818,178	6,791,729
Prepaid expenses and deposits	872,853	778,273
Current assets – discontinued operations	10,801,852	12,012,577
	27,049,556	30,390,997
<b>Long-term</b>		
Capital assets	10,074,647	10,422,860
Goodwill	2,049,791	2,049,791
Intangible assets, net	9,985,296	10,403,251
Deferred financing fees, net	2,395,868	838,055
Other assets – deferred costs	576,000	576,000
Long-term assets – discontinued operations	29,611,065	28,868,602
	81,742,223	83,549,556
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Revolving credit facility [note 6]	4,080,650	—
Term bridge loan [note 6]	8,744,250	—
Accounts payable and accrued liabilities	7,798,326	7,015,841
Income taxes payable	538,688	584,101
Deferred government incentives	2,986,572	3,162,577
Current portion of senior and other long-term debt	1,579,805	3,634,986
Current liabilities – discontinued operations	16,525,418	17,276,398
	42,253,709	31,673,903
<b>Long-term</b>		
Senior debt [note 6]	6,165,304	2,458,946
Other long-term debt	—	10,800,000
Obligations under capital lease	941,327	994,457
Deferred government incentives	400,118	363,167
Long-term liabilities – discontinued operations	16,618,002	15,926,257
	66,378,460	62,216,730
<b>Shareholders' equity</b>		
Share capital [note 2]	72,356,378	70,382,951
Other paid-in capital [note 2]	4,373,013	3,038,050
Deficit	(61,730,913)	(52,726,240)
Cumulative translation amount	365,285	638,065
	15,363,763	21,332,826
	81,742,223	83,549,556

See accompanying notes

**Bioniche Life Sciences Inc.**  
(Unaudited)**CONSOLIDATED STATEMENTS OF DEFICIT***(see Note 1)*

For the three and six months ended December 31	Current Quarter 2005 \$	Last Year Quarter 2004 \$	Current Year to Date 2005 \$	Last Year Year to Date 2004 \$
<b>Balance, beginning of period</b>	(56,048,703)	(41,838,281)	(52,726,240)	(37,123,268)
Net loss for the period	(5,682,210)	(4,863,226)	(9,004,673)	(9,578,239)
<b>Balance, end of period</b>	(61,730,913)	(46,701,507)	(61,730,913)	(46,701,507)

*See accompanying notes*

**Bioniche Life Sciences Inc.**  
(Unaudited)

### CONSOLIDATED STATEMENTS OF LOSS

(see Note 1)

For the three and six months ended December 31	Current Quarter 2005 \$	Last Year Quarter 2004 \$	Current Year to Date 2005 \$	Last Year Year to Date 2004 \$
<b>REVENUE</b>				
Sales	7,422,051	6,813,702	13,736,024	13,816,452
Cost of sales	2,732,356	3,065,287	5,411,487	6,466,379
<b>Gross profit</b>	<b>4,689,695</b>	<b>3,748,415</b>	<b>8,324,537</b>	<b>7,350,073</b>
<b>EXPENSES</b>				
Administration	1,418,054	871,009	2,424,639	1,720,646
Marketing and selling	1,735,915	1,993,533	3,198,072	3,487,313
Quality assurance	268,992	234,240	517,896	443,520
Interest on long-term debt	365,685	461,119	999,407	934,344
Other interest	98,002	10,501	75,597	18,851
Share ownership and bonus	99,944	214,182	233,115	430,023
Amortization of capital assets	309,066	218,256	611,362	415,315
Amortization of intangible and other assets	214,130	214,130	428,260	428,259
Amortization of deferred financing fees	221,924	88,290	290,263	174,042
Debt refinancing [note 6]	2,493,920	—	2,493,920	—
Foreign exchange loss	260,861	9,875	493,704	209,242
	<b>7,486,493</b>	<b>4,315,135</b>	<b>11,766,235</b>	<b>8,261,555</b>
<b>Loss before research and development and other items</b>	<b>(2,796,798)</b>	<b>(566,720)</b>	<b>(3,441,698)</b>	<b>(911,482)</b>
Research and development expenses, gross	3,170,395	2,870,444	6,159,556	5,847,567
Less government incentives, net	(392,035)	(354,989)	(483,234)	(690,677)
<b>Loss from continuing operations before income taxes</b>	<b>(5,575,158)</b>	<b>(3,082,175)</b>	<b>(9,118,020)</b>	<b>(6,068,372)</b>
(Provision for) recovery of income tax expense	(6,851)	72,970	(35,462)	14,970
<b>Loss from continuing operations</b>	<b>(5,582,009)</b>	<b>(3,009,205)</b>	<b>(9,153,482)</b>	<b>(6,053,402)</b>
Income (loss) from discontinued operations	(100,201)	(1,854,021)	148,809	(3,524,837)
<b>Net loss for the period</b>	<b>(5,682,210)</b>	<b>(4,863,226)</b>	<b>(9,004,673)</b>	<b>(9,578,239)</b>
<b>Basic and diluted net income (loss) per share</b>				
Continuing operations	(0.15)	(0.08)	(0.25)	(0.17)
Discontinued operations	—	(0.05)	—	(0.10)
<b>Total net loss per share</b>	<b>(0.15)</b>	<b>(0.13)</b>	<b>(0.25)</b>	<b>(0.27)</b>

See accompanying notes

**Bioniche Life Sciences Inc.**  
(Unaudited)

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(see Note 1)

For the three and six months ended December 31	Current Quarter 2005 \$	Last Year Quarter 2004 \$	Current Year to Date 2005 \$	Last Year Year to Date 2004 \$
<b>OPERATING ACTIVITIES</b>				
Loss from continuing operations	(5,582,009)	(3,009,205)	(9,153,482)	(6,053,402)
Add (deduct) non cash items:				
Amortization	745,120	520,676	1,329,885	1,017,616
Foreign exchange	129,936	14,498	103,121	4,101
Share, option, and warrant compensation	127,536	126,492	200,711	132,836
Share bonus	—	284,000	—	673,000
Employee share ownership plan	141,840	145,225	278,194	279,967
Debt refinancing [note 6]	1,271,454	—	1,271,454	—
	(3,166,123)	(1,918,314)	(5,970,117)	(3,945,882)
Net changes in non-cash working capital balances related to operations	62,532	(828,444)	926,207	(1,312,472)
<b>Cash used in operating activities</b>	<b>(3,103,591)</b>	<b>(2,746,758)</b>	<b>(5,043,910)</b>	<b>(5,258,354)</b>
<b>INVESTING ACTIVITIES</b>				
Payment relating to acquisition of net assets	—	(806,560)	(123,120)	(1,019,163)
Government incentives received on account of capital assets	53,730	—	53,730	6,458
Purchase of capital assets	(193,569)	(398,662)	(316,913)	(747,361)
<b>Cash used in investing activities</b>	<b>(139,839)</b>	<b>(1,205,222)</b>	<b>(386,303)</b>	<b>(1,760,066)</b>
<b>FINANCING ACTIVITIES</b>				
Proceeds from revolving credit facility	4,051,250	—	4,051,250	—
Proceeds from term bridge loan	8,681,250	—	8,681,250	—
Preferred shares issued	—	11,674,854	—	11,674,854
Common shares issued	1,053,693	—	1,053,693	—
Proceeds from convertible term note	7,048,807	—	7,048,807	—
Financing fees – debt	(1,368,789)	30,886	(1,368,789)	(20,968)
Proceeds on account of deferred government incentives	693,861	198,779	693,861	393,298
Repayment of senior and other long-term debt	(16,038,627)	(195,622)	(16,246,731)	(386,100)
<b>Cash provided by financing activities</b>	<b>4,121,445</b>	<b>11,708,897</b>	<b>3,913,341</b>	<b>11,661,084</b>
Net increase (decrease) in cash from continuing operations	878,015	7,756,917	(1,516,872)	4,642,664
Net increase in cash from discontinued operations	101,963	142,203	285,085	352,405
Net increase (decrease) in cash for the period	979,978	7,899,120	(1,231,787)	4,995,069
Cash, beginning of period	1,315,643	1,018,847	3,527,408	3,922,898
<b>Cash, end of period</b>	<b>2,295,621</b>	<b>8,917,967</b>	<b>2,295,621</b>	<b>8,917,967</b>

See accompanying notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005 and 2004 — Unaudited

### 1. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY

The Company has incurred significant losses and cash outflows from operations to date. As at December 31, 2005, the Company's committed cash obligations and expected level of expenses for the remainder of the fiscal year exceed the committed sources of funds and the Company's cash balances on hand. After receipt of the proceeds of the sale of Bioniche Pharma Group as outlined in note 7, the Company will require additional financial resources in order to support the commercialization of its core technologies currently under development. The ability of the Company to continue as a going concern is dependent upon the continued support of its lenders and its ability to establish the technological feasibility of its products, bring its products to market, obtain regulatory approvals, achieve future profitable operations, and to obtain additional financing. The outcome of these matters is dependent on a number of items outside the Company's control. If the Company is unable to obtain adequate financing, management will be required to curtail its operations. As a result, there is significant uncertainty as to whether the Company will have the ability to continue as a going concern.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities which might be necessary should the Company be unable to continue in business and such adjustments could be material.

These interim financial statements do not contain all disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, these financial statements should be read in conjunction with the most recently prepared annual financial statements for the year ended June 30, 2005. These unaudited interim consolidated financial statements follow the same accounting policies and methods of their application as outlined in the most recent annual consolidated financial statements.

The second half of the year, from January to June, normally generates stronger revenues from the Animal Health reproductive products due to the timing of the breeding season.

### 2. SHARE CAPITAL AND OTHER PAID-IN CAPITAL

Issued share capital consists of:

	December 2005 \$	June 2005 \$
Preferred shares — Series 1 — 167 [June 2005 — 167]	161,000	161,000
Preferred shares — Series 2 — 12,000,000 [June 2005 — 12,000,000]	11,731,716	11,731,716
Common shares — 38,816,762 [June 2005 — 36,324,967]	60,463,662	58,490,235
	72,356,378	70,382,951

At December 31, 2005 the Company has issued 254,971 shares under the employee share ownership plan in the current fiscal year valued at \$266,524, of which \$45,009 relates to the accrued balance at June 30, 2005 included in Other paid-in capital. In addition, the Company has issued 138,465 shares to Directors in lieu of payment of fees, valued at \$90,002 and issued 529 shares under the share bonus plan, valued at \$1,275 [a].

As part of the corporate debt restructuring as it relates to the settlement of the Company's debenture with a syndicate of Canadian institutions, 764,042 shares were issued as partial payment for a make-whole agreement, recorded at \$611,233. During the quarter, 1,333,788 shares were purchased by Laurus Master Funds, Ltd. in a private financing, recorded at \$1,004,393, net of costs of \$49,300.

Other paid-in capital consists of:

	December 2005 \$	June 2005 \$
Accrued share bonus [a]	19,888	21,163
Accrued employee share ownership plan	56,680	45,009
Warrants [b]	1,755,672	1,570,714
Accrued warrants	1,200,000	1,200,000
Options [c]	311,873	201,164
Equity component of convertible term note [note 6]	1,028,900	—
	4,373,013	3,038,050

#### (a) Share Bonus

No share bonus has been accrued during the first two quarters. The outstanding balance represents the value of previous year bonuses that employees have elected to defer to a future period.

#### (b) Warrants

On December 8, 2005, as part of the fees related to the private financing, the Company issued 800,000 five-year warrants to purchase 800,000 common shares with an exercise price of \$1.10. The fair value of these warrants has been determined to be \$184,958 or \$0.23 per warrant using the Black-Scholes pricing model with the following assumptions; risk-free interest rate of 4.50%, expected dividend yield of 0%, expected volatility of 0.3783 and expected life of 5 years.

#### (c) Options

On September 20, 2005, 50,000 stock options were granted at \$1.10 per share to employees. Under the Company's share option plan, options may be granted with an exercise price not less than the market price on the date of the grant. The fair value of these stock options, determined using the fair value method, was \$22,800. These options will be expensed over the vesting period. The amount of compensation expense to date for all outstanding options is \$110,709.

The following weighted average assumptions were used to determine the fair value of these options: risk-free interest rate of 4.50%, expected dividend yield of 0%, expected volatility of 0.3918 and expected option life of five years resulting in a weighted fair value per option of \$0.456. The Company uses the Black-Scholes model to calculate the fair value of options awarded.

During the first two quarters, 466,500 options with an average exercise price of \$3.64 per share have expired.

On January 12, 2006, the Company granted 1,160,000 options at \$0.90 per share to employees and directors. The fair value of these stock options is \$259,000, as determined using the Black-Scholes model with the following assumptions: risk-free interest rate of 5.00%, expected dividend yield of 0%, average expected volatility of 0.3797 and expected option life of five years. These options will be expensed over the vesting period.

### 3. GOVERNMENT INCENTIVES

In conjunction with the resolution of the issues relating to the Technology Partnership Canada agreements in the first quarter, the claims receivable for government incentives were reduced by \$377,889, of which \$198,846 was reflected as a reduction in the Consolidated Statements of Loss. The adjustment was a result of an assessment of certain of the expenditures claimed as being non-qualifying.

### 4. SEGMENTED FINANCIAL INFORMATION

The Company's three reportable segments in continuing operations: Animal Health, Human Health and Food Safety are strategic business units that offer different products and require different technology and marketing strategies. The Company's reportable business segments historically included the Pharma division which was previously classified as a separate segment. This segment has been classified as discontinued operations for financial reporting purposes and is outlined in note 5.

The Company accounts for inter-segment sales on a cost plus basis.

Current Quarter December 2005				
	Human Health	Animal Health	Food Safety	Total
<b>Sales</b>	\$1,286,067	\$6,135,984	—	\$7,422,051
Cost of sales	353,976	2,378,380	—	2,732,356
Expenses	652,311	2,870,594	—	3,522,905
<b>EBITDA before research and development</b>	279,780	887,010	—	1,166,790
Research and development expenses	2,154,298	692,572	323,525	3,170,395
Less government incentives	(341,344)	—	(50,691)	(392,035)
<b>Net research and development expenses</b>	1,812,954	692,572	272,834	2,778,360
Interest expense, net	348,388	115,299	—	463,687
Amortization expense	445,017	286,515	13,588	745,120
Foreign exchange loss				260,861
Debt refinancing				2,493,920
<b>Segment income (loss) before taxes</b>	<b>(2,326,579)</b>	<b>(207,376)</b>	<b>(286,422)</b>	<b>(5,575,158)</b>

Last Year Quarter December 2004				
	Human Health	Animal Health	Food Safety	Total
<b>Sales</b>	\$1,171,221	\$5,642,481	—	\$6,813,702
Cost of sales	350,700	2,714,587	—	3,065,287
Expenses	477,226	2,835,738	—	3,312,964
<b>EBITDA before research and development</b>	343,295	92,156	—	435,451
Research and development expenses	1,991,766	599,643	279,035	2,870,444
Less government incentives	(284,093)	(31,684)	(39,212)	(354,989)
<b>Net research and development expenses</b>	1,707,673	567,959	239,823	2,515,455
Interest expense, net	376,244	95,376	—	471,620
Amortization expense	298,090	216,906	5,680	520,676
Foreign exchange loss				9,875
<b>Segment income (loss) before taxes</b>	<b>(2,038,712)</b>	<b>(788,085)</b>	<b>(245,503)</b>	<b>(3,082,175)</b>

Current Year to Date 2005				
	Human Health	Animal Health	Food Safety	Total
<b>Sales</b>	\$1,971,897	\$11,764,127	—	\$13,736,024
Cost of sales	503,803	4,907,684	—	5,411,487
Expenses	1,275,877	5,097,845	—	6,373,722
<b>EBITDA before research and development</b>	192,217	1,758,598	—	1,950,815
Research and development expenses	4,093,669	1,354,820	711,067	6,159,556
Less government incentives	(358,524)	—	(124,710)	(483,234)
<b>Net research and development expenses</b>	3,735,145	1,354,820	586,357	5,676,322
Interest expense, net	826,630	248,374	—	1,075,004
Amortization expense	747,464	568,460	13,961	1,329,885
Foreign exchange loss				493,704
Debt refinancing				2,493,920
<b>Segment income (loss) before taxes</b>	<b>(5,117,022)</b>	<b>(413,056)</b>	<b>(600,318)</b>	<b>(9,118,020)</b>

	Last Year to Date 2004			
	Human Health	Animal Health	Food Safety	Total
<b>Sales</b>	\$2,320,406	\$11,496,046	—	\$13,816,452
Cost of sales	735,600	5,730,779	—	6,466,379
Expenses	855,371	5,226,131	—	6,081,502
<b>EBITDA before research and development</b>	729,435	539,136	—	1,268,571
Research and development expenses	3,810,983	1,353,699	682,885	5,847,567
Less government incentives	(521,982)	(31,684)	(137,011)	(690,677)
<b>Net research and development expenses</b>	3,289,001	1,322,015	545,874	5,156,890
Interest expense, net	756,890	196,305	—	953,195
Amortization expense	587,218	419,978	10,420	1,017,616
Foreign exchange loss				209,242
<b>Segment income (loss) before taxes</b>	<b>(3,903,674)</b>	<b>(1,399,162)</b>	<b>(556,294)</b>	<b>(6,068,372)</b>

## 5. DISCONTINUED OPERATIONS

The Company's Board of Directors resolved in May 2005 to dispose of the Bioniche Pharma segment of its business comprised of manufacturing operations in Galway, Ireland and sales operations in Canada and the United States. The cash flow generated by this transaction will allow the Company to reduce its debt load and refocus on its key strategic priorities: the Phase III clinical trial with its Mycobacterial Cell Wall-DNA Complex (MCC) for bladder cancer and the licensing of its *E. coli* O157:H7 vaccine for cattle. Accordingly, all revenues, expenses, assets and liabilities related to the Pharma segment have been classified as discontinued operations for fiscal 2006 and 2005.

## INCOME (LOSS) FROM DISCONTINUED OPERATIONS

For the three and six months ended December 31

	Current Year Quarter 2005	Last Year Quarter 2004	Current Year to Date 2005	Last Year Year to Date 2004
Revenues	\$5,389,537	\$3,657,118	\$10,886,587	\$6,926,449
Cost of sales	2,320,633	1,699,214	4,347,430	3,070,791
Gross profit	3,068,904	1,957,904	6,539,157	3,855,658
Expenses	2,881,657	3,146,654	5,043,088	5,833,265
EBITDA before R&D	187,247	(1,188,750)	1,496,069	(1,977,607)
Net research and development	(350,731)	(178,268)	(717,248)	(385,566)
Interest and amortization	68,391	(513,917)	(379,924)	(1,208,818)
Income tax expense	1,855	—	(216,145)	—
Non-controlling interest	(6,963)	26,914	(33,943)	47,154
Income (loss)	(100,201)	(1,854,021)	148,809	(3,524,837)

## CASH FLOW FROM (USED IN) DISCONTINUED OPERATIONS

For the three and six months ended December 31

	Current Year Quarter 2005	Last Year Quarter 2004	Current Year to Date 2005	Last Year Year to Date 2004
Operating activities	2,102,776	(1,620,203)	3,682,303	590,429
Investing activities	(1,435,424)	(5,123,926)	(2,100,435)	(8,310,991)
Financing activities	(410,331)	6,664,621	(837,334)	8,117,515
Effect of foreign currency translation	(155,058)	221,711	(459,449)	(44,548)
Net cash provided	101,963	142,203	285,085	352,405

## 6. CORPORATE DEBT RESTRUCTURING

On December 9, 2005, the Company completed a private financing with a U.S.-based institutional investor for \$18,500,000 US, consisting of shares, debt, convertible debt, and warrants, the proceeds of which were used to refinance existing North American debt and for working capital purposes. This financing consists of the following components:

### Revolving Credit Facility

A three-year, \$4,000,000 US revolving credit facility, based on 90% of eligible accounts receivable and 35% of eligible North American inventory capped at \$2,500,000 US. At the option of the Company, the principal may be paid in cash and/or shares at 85% of the 10-day volume weighted average trading price ("VWAP") of Bioniche common shares on the TSX at the time of payment and amounts so paid may be re-borrowed subject to the borrowing base limitations. Interest is payable monthly in cash at Wall Street Journal (WSJ) prime. As at December 31, 2005, \$3,500,000 US (\$4,080,650 CDN) has been drawn on this facility.

### Bridge Facility

A four-month, \$7,500,000 US bridge loan to be repaid from the proceeds of the sale of Bioniche's Pharma operation [note 7]. Interest is payable monthly in cash at the greater of 6.5% and the WSJ prime plus 3% for the four-month period or as described below if extended. As at December 31, 2005 \$7,500,000 US (\$8,744,250 CDN) has been drawn on this facility. This loan was fully repaid on February 1, 2006 with proceeds from the closing of the Pharma sale.

### Convertible Term Note

A three-year, \$7,000,000 US convertible term note, repayable in equal monthly installments making up 20% of the principal amount in the first year, 20% of the principal amount in the second year and 60% of the principal amount in the third year, except for the first two payments which have been deferred to the final payment of the note. The fair value of the holder's conversion option, net of \$85,100 in fees is calculated to be \$1,028,900 CDN assuming an imputed interest rate of 29%. This has been reported as Other paid-in capital. The value of the note is shown as \$1,166,667 US (\$1,360,217 CDN) in current portion of senior and other long-term debt and \$4,867,333 US (\$5,732,645 CDN) in senior long-term debt. A debt discount of \$915,000 US (\$1,053,693 CDN) recognized in relation to the convertible term note, is included in deferred financing fees, and will be amortized over the term of the note.

The monthly installments must be settled in shares if the market price of the common shares on the TSX on each due date is greater than or equal to 115% of the fixed conversion price and the amount of such conversion does not exceed 25% of the aggregate dollar trading volume of common shares for the 22 day trading period immediately preceding the due date (conversion criteria). The fixed conversion price is \$0.88 per share on 50% of the principal amount of the note and \$1.05 on the balance. Interest is payable monthly in cash, calculated on the outstanding principal balance at the greater of 6.5% and the WSJ prime plus 2%, decreasing by 2% (but never less than 0%) for every 25% increase in the Market Price above the fixed conversion price. Market Price is determined as the volume weighted average trading price on the TSX for the ten trading days immediately preceding the last business day of each month. The Company has the right to prepay the note, in whole or in part, at any time by giving 10 business days written notice and paying 130% of the outstanding principal amount of the note. The holder may convert the note, in whole or in part, into shares of common stock at any time upon one business day's prior written notice.

### Collateral Pledged

The Company has given a first charge over all of the assets of the Company except for certain intellectual property which is subject to a negative pledge pursuant to an agreement with the Government of Canada.

### Common Stock Purchase Warrant

The Company issued a five-year warrant to purchase 800,000 shares of common stock at \$1.10 per share. The fair value of the warrants, determined using the Black-Scholes model, was \$184,958 and has been included in deferred financing costs. [See note 2(c) for assumptions]

### Debt Refinancing Costs

A make-whole payment of \$1,833,699 was made to the syndicate of Canadian institutions upon discharge of the debenture, of which \$611,233 was settled in shares and \$1,222,466 in cash. Included in debt refinancing is the unamortized deferred financing costs related to the loans discharged, totaling \$660,221, as well as the make-whole payment.

Total financing fees incurred with respect to the new debt, including the fair value of the warrants [note 2], was \$1,553,748 CDN and was allocated to the various components. This amount will be amortized over the term of each component.

Principal repayments required, including the equity component of the convertible term note, are as follows:

	Senior Debt (\$)	Capital Leases (\$)	Total
Balance of 2006	553,375	67,274	620,649
2007	1,651,372	84,895	1,736,267
2008	3,285,261	84,699	3,369,960
2009	2,742,943	88,997	2,831,940
2010	24,428	101,060	125,488
Thereafter	352,184	718,386	1,070,570
	8,609,563	1,145,311	9,754,874

### 7. SUBSEQUENT EVENTS

On February 1, 2006, the Company completed the sale of a majority of its ownership in Bioniche Pharma Group Limited to RoundTable Healthcare Partners. Proceeds of the sale are \$13.25 million US in cash which the Company estimates will result in a gain of \$9.1 million, net of estimated costs of \$0.75 million on closing. In addition, the Company will receive a 10% ownership in the new Pharma Group which will be accounted for using the cost method and will receive up to \$11.6 million US in aggregate performance payments providing the Pharma Group meets certain earning targets in each of the next four years. The Company will also receive future payments of up to 1 million Euro per year for the next five years based on the amount of future sales of *Suplasyn*.

### 8. RELATED PARTY TRANSACTIONS

During the period to December 31, 2005, the Company made monthly lease payments of \$16,667 per month to a company controlled by the CEO and Director of Bioniche.

### 9. COMPARATIVE AMOUNTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current period consolidated financial statements.