

Acting on innovation

Annual Report



Human Health	Food Safety	Animal Health
<p>Bioniche Therapeutics</p> <ul style="list-style-type: none"> • Drug discovery & development • Products based on proprietary technologies • Development: bladder cancer, other cancers 	<p>Bioniche Food Safety</p> <ul style="list-style-type: none"> • Development of animal vaccines to help enhance food & water safety • <i>E. coli</i> O157 cattle vaccine fully licensed in Canada • Other animal vaccines in pipeline (<i>Salmonella</i>, <i>Campylobacter</i>, <i>Listeria</i>) 	<p>Bioniche Animal Health</p> <ul style="list-style-type: none"> • Largest Canadian-owned animal health company • Foci: reducing reliance on antibiotics (immunology); enhancing reproductive performance; and preventing illness (vaccines)

Bioniche Life Sciences Inc. is a publicly-traded company, listed on the Toronto Stock Exchange under the symbol "BNC" since 1992. The corporate headquarters are located in Belleville, Ontario, Canada, and the Company owns and operates various offices and manufacturing plants in Canada, the United States, Europe, and Australia. Bioniche employs approximately 211 individuals.

Fiscal 2010 Financial Highlights, with Fiscal 2009 & 2008 Comparisons

<i>In C\$000s</i>	Year ended June 30, 2010	Year ended June 30, 2009	Year ended June 30, 2008
Revenue	45,899	33,281	27,568
Net loss	(1,590)	(10,500)	(16,256)
Based and diluted net loss per share	(0.02)	(0.15)	(0.26)
Cash	11,070	5,950	4,399
Total assets	52,139	34,641	34,623
Long-term liabilities			
Long-term debt	1,341	1,149	1,674
Obligations under capital lease	1,184	1,225	1,424
Government assistance	6,964	2,476	—
Deferred government incentives	2,382	3,336	3,607

Corporate History/Business Strategy

The Company was founded by Graeme McRae as Vetrepharm, an Animal Health company, in 1979. At that time, the Company was located in London, Ontario. Mr. McRae believed that the major veterinary pharmaceutical companies were putting insufficient research efforts into alternatives to antibiotics as treatments for livestock disease. He believed that there had to be more suitable ways of treating veterinary diseases that did not have the problems associated with antibiotics, such as, leaving residues in the food chain and promoting the development of resistant bacteria species. Thus, Vetrepharm was established to research and develop such alternatives, and this commitment has remained throughout the Company's 31 years of existence. In the course of developing these technologies, the Company supported itself by developing a number of new product technologies, manufacturing these products and selling them to veterinarians.

This has proven to be a sustainable approach in managing the business, growth, scope of development and building shareholder value. Manufacturing and product sales have been a key component in providing stability to the business and its development activities. Consequently, the Company believes the best way to create long-term shareholder value is to generate increasing cash flows from operations as a result of registration and commercialization of internally developed products. While it is the Company's preference to participate as much as possible in the full life cycle of products developed internally, some projects benefit from alignment with marketing and commercialization partners, such as Endo Pharmaceuticals Inc. for *Urocidin™*. Whenever possible, the Company will manufacture the products it develops for a far superior margin than would be available through conventional licensing agreements with external manufacturers and distributors. Currently, two major products developed internally (*Urocidin™* and *Econiche™*) are in their final stages of development and are advancing through the appropriate regulatory pathways, and the Company has plans to retain the manufacturing of these products.

Over the years, the Company has primarily raised equity to finance its development activities. Going forward, the Company's plan is to fund ongoing development from growing and sustainable operating results, and to fund the construction and development of manufacturing facilities using conventional long-term financial instruments, including government assistance where possible.

Goals and Objectives

The Company's goals and objectives are to execute its business strategy by:

1. Taking existing proprietary technologies and continue, through the product development program, to enhance their proven therapeutic value for human and animal use.
2. Working to develop these technologies to the point of commercialization, either alone or with strategic marketing partners.
3. Manufacturing as many products emerging from the product development program as possible to increase profit margins, protect the integrity of the Company's products, and enhance long-term shareholder value.



Graeme McRae

Dear Fellow Shareholders,

Fiscal 2010 has come to a close, and what an eventful year it was! The signing of a licensing, development and supply agreement in July, 2009 for *Urocidin*[™], a formulation of Mycobacterial Cell Wall-DNA Complex (MCC) for the treatment of bladder cancer, was a major step forward in the Company's progress. The agreement triggered an immediate payment of US\$20 million to the Company, along with the potential for up to US\$110 million in milestone payments. During Fiscal 2010, three of these payments were received by the Company, for total proceeds of US\$14 million.

Our licensing partner — Endo Pharmaceuticals Inc. (Endo) — originally took up rights to *Urocidin*[™] for the United States and Mexico (and, subject to co-marketing rights, Canada), with a 12-month option to expand the territory to comprise global marketing rights. In February, 2010, Endo exercised its option for global rights, thereby becoming responsible for 100% of external development costs related to the ongoing Phase III clinical program for *Urocidin*[™]. The Company continues to contribute internal resources for this program at its own expense. Some of the internal expense is offset by a recovery from Endo — approximately \$1.8 million in Fiscal 2010.

As the data from the first Phase III clinical trial with *Urocidin*[™] — in patients whose bladder cancer is refractory (unresponsive) to BCG therapy — was being analyzed by Endo, the two companies were finalizing a protocol for an additional clinical trial with *Urocidin*[™]. This new Phase III trial is expected to begin enrolling patients in calendar 2010. Details of the new protocol, when finalized, will be made publicly available via the U.S. National Institutes of Health clinical trial registration service at <http://www.clinicaltrials.gov>.

Given that Endo is now responsible for the *Urocidin*[™] clinical development program, with input from the Company, the resources of the internal pre-clinical and clinical teams can be reassigned to new tasks. Under the agreement with the Company, Endo was also granted a right of first negotiation for other clinical indications of MCC technology (beyond bladder cancer), where such clinical indications relate to urology or pelvic disease. However, the Company's pre-clinical research over the years has demonstrated potential efficacy of MCC in a range of human cancers, and the Company is now considering additional indications to explore through new, early stage clinical assessment.

In addition to the above-noted payments under the licensing agreement with Endo, Bioniche retained exclusive product manufacturing rights and will receive a net-sales-related transfer price for supplying Endo with commercial product following regulatory approval. The Company is working to find third-party, non-equity funding to build-out sufficient commercial production capacity for *Urocidin*[™] in advance of its registration.

Animal Health & Food Safety Vaccine Manufacturing Centre

During the fiscal year, the Company has made significant progress in the construction of a new Animal Health & Food Safety Vaccine Manufacturing Centre (VMC) at its Belleville, Ontario site. When completed at the end of March, 2011, the VMC will be a "state-of-the-art" production facility, the only such facility in Canada and one of only a few in North America.

The VMC is being built to "Good Manufacturing Practice" standards and, once the building, equipment, and production processes are validated, will be capable of producing a wide range of vaccines. Financing for the \$25 million project consists of repayable government assistance from the Governments of Canada and Ontario amounting to approximately \$20M, together with a mortgage from the Business Development Bank of Canada (BDC) for approximately \$5M.



Installing the floor in the new penthouse (top) level in January, 2010



Progress of internal construction (one level of three) in May, 2010



HVAC equipment being delivered in May, 2010

We were pleased to receive an additional investment of \$750,000 from the Federal Economic Development Agency for Southern Ontario (FedDev Ontario) for a pilot-scale fermentation facility adjacent to the VMC. The announcement was made by Daryl Kramp, MP for Prince Edward Hastings, on behalf of The Honourable Gary Goodyear, Minister of State responsible for FedDev Ontario in April, 2010.

The pilot-scale fermentation facility will be a critical add-on to the VMC. As successful animal health or food safety vaccine candidates are identified and evaluated, they will be brought into this new facility for development, scale-up and preparation for commercial-scale manufacturing.

FedDev Ontario was created as part of the Canada's Economic Action Plan to support economic and community development, innovation, and economic diversification, with contributions to communities, businesses and non-profit organizations in southern Ontario.

In the Food Safety division, our team continues to work with government agencies seeking support for pilot programs to facilitate the use of the *Econiche™ E. coli* O157 cattle vaccine by producers. The vaccine has been available in limited quantities pending the completion of the new Vaccine Manufacturing Centre. Its first sales were recorded during Fiscal 2008 under a *Permit to Release Veterinary Biologics* granted by the Canadian Food Inspection Agency (CFIA) in December, 2006. The vaccine received full licensing approval in Canada by the CFIA in October, 2008, making it the world's first vaccine of its type to be fully registered.

Bioniche is providing all of the required material for a conditional license in the U.S., which we hope to receive by calendar year-end.

The Company continues to work with the Vaccine and Infectious Diseases Organization (VIDO) at the University of Saskatchewan and the University of British Columbia to identify and develop new vaccine candidates to fight zoonotic diseases (those that are spread from animals to humans), including *Salmonella enteritidis*, *Campylobacter jejuni* and *Listeria*. In North America, *Campylobacter*, *Salmonella*, and *E. coli* are the three leading causes of bacterial gastroenteritis.

Animal Health Business

The revenues from the Animal Health business unit, which has a history of generating positive earnings before interest, taxes, depreciation, amortization and foreign exchange ("EBITDA") before research and development expenditures, have traditionally supported the Company's key research and development projects. Fiscal 2010 was a challenging one for this business unit, with a drop in sales as compared to Fiscal 2009. This result largely reflects recessionary conditions in certain markets, as well as the increase in the value of the Canadian dollar versus the U.S. dollar over the course of the fiscal year.

The Company has a product portfolio of more than sixty products, which can be categorized primarily in the following groups: Reproduction and embryo transfer products; products based on hyaluronans; immunostimulant products; polyclonal antibodies; vaccine products; and nutraceuticals. These products are marketed directly to veterinarians in Canada, the United States, Australia and Europe, and through selected distributors in the rest of the world.

The signing of a partnership agreement with Bayer Animal Health, a division of Bayer Australia Limited (June 2, 2010) for the exclusive distribution of two cattle reproduction products in Australia is a good example of the type of creative arrangements that Bioniche Animal Health is pursuing to grow the business. More than ever, beef and dairy producers are striving to improve their reproductive performance, and our products — Cue-Mate® and Pregnecol® — offer exciting new options to do this. A market of over 15 million cows remains relatively untapped in Australia, and market education is critical for *Cue-Mate* and *Pregnecol* to grow. Bayer will assist us in both expanding the market and in establishing a greater presence within it — the growth opportunities are significant.

The partnership with Trophogen Inc., announced on June 23, 2010, has resulted in the development of a high-quality, cost-effective, non-animal-origin, recombinant hormone. This recombinant technology will provide cost and production benefits over the Company's existing follicle stimulating hormone, as well as removing any potential concerns arising from animal-sourced products.

The license agreement signed between the Company and the University of Ottawa (announced on August 25, 2010) provides commercial access for Bioniche to University of Ottawa's technology for botanical therapeutics (natural health) and pharmaceutical compounds for treating anxiety and related conditions in animal health, human health and aquaculture. The Company plans to initially explore developing the technology into animal health products for dogs and horses, where it could help reduce anxiety without the side effects of chemical calming agents. In the future, the Company may also explore the development of human applications for the technology. The licensing agreement includes a commitment to ongoing research at the University of Ottawa.

The improved financial position of the Company during Fiscal 2010 has allowed us to invest in these types of licensing and partnership agreements, as well as to advance our rich internal research and development pipeline. The Company has a number of exciting products that could make a real difference to veterinarians and producers. One such product is a vaccine for horses against *Rhodococcus equi*, a chronic and often fatal cause of bronchopneumonia in foals. The vaccine has been tested and has demonstrated desirable efficacy in controlled challenge studies. The Company is formulating its global regulatory plan for this vaccine.

The Company is also investigating the use of a formulation of mycobacterial cell wall technology for cancer therapy in companion animals. Studies using canine cancer patients are the most effective means of demonstrating the efficacy of this technology as a therapeutic option. Studies may be done with the mycobacterial cell wall formulation alone or in conjunction with standard therapeutic approaches. The Company believes there are significant markets in North America, Europe and Japan that will be receptive to this therapy. Mycobacterial cell wall therapy is expected to improve the quality of life and extend survival beyond what is achieved with current standards of care.

Of course, development work in all areas of the Company requires investment over a number of years prior to reaching the point of regulatory approvals and marketing of new therapeutics. The Company is blessed with a stable shareholder base that continues to believe in our corporate agenda and business model, and we trust that our shareholders will continue to support us as we invest in opportunities for corporate growth.



Graeme McRae

Chairman, President & CEO

The Company believes that shareholders expect it to act responsibly and do the right thing with their investment. This brief report details some initiatives developed by the Company to achieve its mission of improving quality of life through innovation. The Company takes the term 'corporate responsibility' to heart, and is always trying to maintain policies and practices that exceed government regulations. By embodying the core values of integrity, ethics, loyalty and compassion, the Company hopes to create long-term relationships that enhance the well-being of all of its stakeholders.

Responsible to patients through products

The Company's business model is dependent foremost on the health and well-being of its patients (whether human or animal), so steps are taken to protect them from harmful substances and disease. *Urocidin*[™], the Company's bladder cancer therapy that is currently in Phase III clinical trials, is made from a bacterium that is not disease causing. *Econiche*[™], the Company's *E. coli* O157 vaccine for cattle, prevents the attachment of a pathogenic bacterium to the intestinal tract of cattle, thus reducing its shed into the environment (food and water supplies) and protecting humans from infection. All of the Company's products must pass stringent testing before being made available to the public, and are designed for maximum effectiveness with minimal impact throughout their life-cycles.

Responsible to employees through engagement and empowerment

The Company's management team has worked hard to design a corporate culture that encourages an inclusive and diverse work environment for employees.



After having been ranked #13 in the 2009 Best Small & Medium Employers in Canada survey performed by the Queen's University School of Business, Queen's Centre for Business Venturing and Hewitt Associates, the Company

once again participated in the 2010 survey. This involves each employee completing a survey to gauge employee recognition, performance management, career opportunities and organizational reputation. The Human Resources department hosts regular focus groups with employees to assess the Company's strengths and areas for improvement. The valuable information gathered from these focus groups is contributing to a "People Strategy" that will further enhance employee engagement and contribute to a stronger corporate culture.

Employee safety is a big priority at Bioniche, and the Company is proud to report that it has not had a lost-time accident since May, 2002. Furthermore, employees have been encouraged to become stewards of the environment by implementing recycling and composting programs at the corporate head office. Paper products are recycled, and kitchen food waste is composted on-site and used to fertilize crops at the Company farm! Every Earth Day for the past six years, Bioniche employees worldwide have taken part in the "Bioniche Community Cleanup" to pick up litter around corporate sites and in public areas.



Responsible to the planet and local communities through philanthropy

The Company believes that its commitment to responsibility should extend beyond the walls of its offices and laboratories. That's why Bioniche financially supports initiatives that contribute to a better planet and community.

Species extinction is a big problem in Australia, where endangered animals live in an often harsh environment. To become part of the solution, the Company has most recently donated embryo transfer media and filters to the Taronga Western Plains Zoo, which has been working with reproductive biologist experts from Berlin's Institute for Zoo and Wildlife Research over the last four years to develop assisted reproductive techniques for non-reproductive female black rhinos. Using the Bioniche donation, two females were superovulated, eggs collected, matured *in vitro* and fertilized.

The primary objective of this research is to develop *in vitro* embryo production technology in the rhinoceros to propagate the genetics of captive black rhino females which are unable to carry young of their own and those which die before they reach their reproductive potential by rescuing their eggs post-mortem. This year, the incredible teamwork of this group of researchers resulted in the creation of the world's first rhino embryo.

The Company has a corporate reputation for giving back to its communities. The Company routinely sponsors fundraising events, does collections for special needs, and contributes to charitable causes related to health care — especially cancer. This year, the Company is contributing to a new charity: The Sexual Assault Centre for Quinte and District. Bioniche was the first company to step forward in support of the Centre's residential healing centre campaign taking place between December 1, 2010 and August 31, 2011. The campaign will raise funds to set up a permanent home for the residential healing centre, where victims of sexual assault can receive intensive therapy to facilitate their recovery.

The following discussion and analysis is the responsibility of management and should be read in conjunction with the Company's 2010 Annual Consolidated Financial Statements and notes included herewith, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles ["GAAP"] for interim financial statements, together with the Company's annual audited consolidated financial statements and management's discussion and analysis of financial condition and results of operations for the fiscal year ended June 30, 2010, which can be found on SEDAR (www.SEDAR.com). This review was prepared by management from information available as at September 9, 2010.

To the extent any statements made in this document contain information that is not historical, these statements are considered forward-looking and are subject to risks and uncertainties. Actual results, levels of activity, performance, or achievements could differ materially from those projected herein and depend on a number of factors, including the successful and timely completion of research and clinical trials, the uncertainties related to the regulatory process, and the commercialization of the Company's therapeutic products thereafter.

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 under "Risks and Uncertainties". All amounts are in Canadian dollars unless otherwise indicated.

This management's discussion and analysis is current as of September 9, 2010. Where "we", "us", "our", "Bioniche" or the "Company" are utilized, these mean Bioniche Life Sciences Inc. unless otherwise indicated. All percentages reflected herein are calculated on whole amounts as contained in the Company's financial records and financial statements, and not on the rounded amounts as disclosed herein.

Global Overview of the Business

Bioniche is a research-based, technology-driven Canadian biopharmaceutical company that develops, manufactures, and markets proprietary products for human and animal health markets worldwide. The Company employs 211 people and has three operating business units: Human Health, Animal Health, and Food Safety. Corporate headquarters are located in Belleville, Ontario, Canada.

Human Health:

The human health business unit of the Company has research and production facilities and a clinical trial group in Montréal, Québec, Canada. This unit develops novel human cancer therapies, with a focus on the research

and development of the Company's Mycobacterial Cell Wall-DNA Complex ["MCC"] technology platform for the treatment of bladder and other cancers, and its oligonucleotides, which show pre-clinical promise in the treatment of leukemia and other cancers. The Company's strategy is to develop its therapies through Phase II clinical trials and then to establish alliances to complete final clinical trials and achieve regulatory approvals for marketing.

The MCC technology, trademarked *Urocidin*[™] for bladder cancer, is currently in Phase III clinical testing in patients with non-muscle-invasive bladder cancer that is refractory (unresponsive) to the standard therapy. The Phase III clinical program is being carried out in partnership with Endo Pharmaceuticals Inc. ["Endo"] as part of a license, development, and supply agreement dated July 10, 2009.

Animal Health:

The Company's Animal Health business unit develops, manufactures and markets animal health biopharmaceutical products worldwide. The animal health business unit has product development, manufacturing and marketing facilities in Belleville, Ontario, Canada; as well as marketing and production facilities in Athens, Georgia, U.S.A., Pullman, Washington, U.S.A., Melbourne, Victoria, Australia and Armidale, New South Wales, Australia. The Company has progressively grown by using biotechnology to provide the animal health market with innovative solutions to meet the changing needs of the animal health industry.

The revenues from the Animal Health business unit, which has a history of generating positive earnings before interest, taxes, depreciation and amortization ["EBITDA"]¹ before research and development expenditures, have traditionally supported the Company's key research and development projects.

The Company has a product portfolio of more than sixty products, which can be categorized primarily in the following groups: Reproduction and embryo transfer products; products based on hyaluronans; immunostimulant products; polyclonal antibodies; vaccine products; and nutraceuticals. These products are marketed directly to veterinarians in Canada, the United States, Australia and Europe, and through selected distributors in the rest of the world.

1. Please refer to "Non-GAAP and Other Measures" section

Food Safety:

The Food Safety business unit of the Company — Bioniche Food Safety — was established in July, 2001. The unit is responsible for researching, developing, manufacturing and marketing veterinary biopharmaceutical products to help improve the safety of food and water supplies. The lead initiative for this unit is the development and commercialization of a cattle vaccine, *Econiche*[™], used to reduce the spread of the deadly *Escherichia coli* (*E. coli*) O157 organism. This vaccine was developed to reduce the burden of the pathogenic bacterium *E. coli* O157 in cattle and their manure, thereby reducing contamination of the environment, ground water, and cattle processing plants. The vaccine has been shown to reduce the amount of bacteria shed by cattle, and to reduce the number of animals in which the bacteria colonize. The fewer bacteria reproducing in the cow, the fewer bacteria will be shed in its manure, affecting the environment and the carcass during food processing.

The vaccine is now available in very limited quantities and its first sales were recorded during Fiscal 2008 under a *Permit to Release Veterinary Biologics* granted by the Canadian Food Inspection Agency ["CFIA"] in December, 2006.

On October 27, 2008, the Company announced that *Econiche*[™], which is the world's first vaccine developed to reduce the shedding by cattle of *E. coli* O157, had received full licensing approval from the CFIA for sale in Canada. The Company is in the process of pursuing similar licensing approval from the United States Department of Agriculture ["USDA"]. Sales have been constrained to date, due in part to limited production capacity and the need to provide vaccine for regulatory purposes and market-related studies.

The Company, in partnership with the Vaccine and Infectious Diseases Organization ["VIDO"] at the University of Saskatchewan and Natural Science and Engineering Research Canada, has sponsored two research positions — *Natural Science and Engineering Research Canada* ["NSERC"]/*Bioniche Industrial Research Chairs* — in vaccines to reduce food and water contamination. Dr. Andrew Potter (Senior Chair) and Dr. Wolfgang Köster (Associate Chair) were appointed to these positions. The Research Chairs were established to undertake research leading to the development of additional food safety vaccines to fight infectious diseases of animals, including *Salmonella enteritidis*, *Campylobacter jejuni* and *Listeria*.

Key Developments in Fiscal 2010:

LICENSE, DEVELOPMENT AND SUPPLY AGREEMENT WITH ENDO PHARMACEUTICALS INC.

On July 10, 2009, Bioniche announced that it had accomplished its goal of securing a strategic partnership to undertake the commercialization of *Urocidin*[™]. This strategic partnership was struck with Endo Pharmaceuticals Inc. of Chadds Ford, Pennsylvania, a publicly-listed company (ENDP — NASDAQ). Endo is a speciality pharmaceutical company engaged in the research, development, sale and marketing of branded and generic prescription pharmaceuticals used to treat and manage pain, overactive bladder and prostate cancer, among other categories. The history of Endo can be traced back as far as 1920. Endo re-commenced operations as a division of Dupont Merck in 1994, became independent via a 1997 management buy-out from the Dupont Merck Pharmaceutical Company, and went public in 2000. Since that time, Endo has increased revenues by ten-fold. Endo markets its branded pharmaceutical products to physicians in pain management, urology, neurology, surgery, oncology, endocrinology and primary care. More information, including past press releases, is available at www.endo.com.

Under the License, Development and Supply Agreement [the "Agreement"], Endo licensed from Bioniche rights to develop and market *Urocidin*[™] (identified by Endo as EN3348), for the treatment of non-muscle-invasive bladder cancer. The territories originally licensed consisted of the United States, Mexico and, subject to co-marketing rights, Canada. The Agreement also included a 12-month option to expand the territory to comprise global marketing rights.

Upon signing the Agreement, Bioniche received an up-front cash payment of US\$20M. The Company also had the potential to receive up to US\$110M in additional payments linked to the achievement of future clinical, regulatory and commercial milestones, three of which have since been achieved, for total proceeds of US\$14M. In addition to the above payments, Bioniche retained exclusive product manufacturing rights and will receive a net-sales-related transfer price for supplying Endo with commercial product following regulatory approval. Bioniche believes the Agreement provides overall economics that are superior to most biotech-pharma partnership agreements and that Endo represents an optimal development and commercialization partner due to its market and industry expertise. Endo was also granted a right of first negotiation for other clinical indications of MCC technology, where such clinical indications relate to urology or pelvic disease. Should Endo not elect to enter such negotiations and the parties conclude them to mutual satisfaction within a set period, the Company shall have no further obligations and Endo no further rights.

On February 12, 2010, the Company announced that Endo elected to exercise its option for exclusive rights to develop and market *Urocidin*[™] globally. As a result of this decision, Endo has assumed all remaining external development expenses for the product. Bioniche believes the development funding and milestone packages may be adequate to cover its non-capital expenditure costs through to the first approval date of *Urocidin*[™] in the United States. In any event, the Company is seeking third-party, non-equity funding to build-out sufficient commercial production capacity for *Urocidin*[™].

ANIMAL HEALTH & FOOD SAFETY VACCINE MANUFACTURING CENTRE

During the year ended June 30, 2010, the Company has made significant progress in the construction of a new Animal Health & Food Safety Vaccine Manufacturing Centre ["VMC"] at its Belleville, Ontario site. The VMC will be a "state-of-the-art" production facility, the only such facility in Canada and one of only a few in North America. The VMC is being built to "Good Manufacturing Practice" standards and, once the building, equipment, and production processes are validated, will be capable of producing a wide range of vaccines. Construction costs of approximately \$8M have

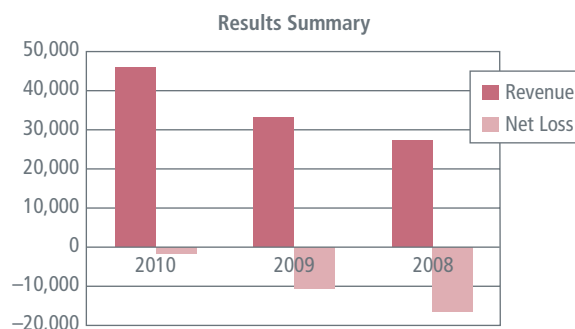
been capitalized as "construction in progress" in Fiscal 2010, and the project is expected to have a completed cost of approximately \$25M. Financing for the VMC project consists of repayable government assistance from the Governments of Canada and Ontario amounting to approximately \$20M, together with a mortgage from the Business Development Bank of Canada ["BDC"] for approximately \$5M. These financing arrangements are more completely described in notes 9 and 11 to the Company's 2010 annual consolidated financial statements.

IMPACT OF ECONOMIC RECESSION IN CERTAIN MARKETS

While significant progress has been made on these two important initiatives, the recession has had some impact on Animal Health sales and operating results. Sales for the year ended June 30, 2010 were down to \$27M from \$33M in Fiscal 2009, primarily from weakness in the fertility and performance equine markets. These markets are expected to recover over the next two years. In spite of recessionary challenges, the Animal Health business unit continued to generate EBITDA¹ before Research and Development of \$8.6M [\$12.2M in Fiscal 2009] and segmented income before income tax of approximately \$4.9M [\$9.6M in Fiscal 2009].

Selected Annual Financial Information

	Year ended June 30, 2010	Year ended June 30, 2009	Year ended June 30, 2008
Revenue	45,899	33,281	27,568
Net loss	(1,590)	(10,500)	(16,256)
Basic and fully diluted net loss per share	(0.02)	(0.15)	(0.26)
Cash	11,070	5,950	4,399
Total assets	52,139	34,641	34,623
Long-term debt	1,341	1,149	1,674
Long-term obligations under capital lease	1,184	1,225	1,424
Long-term repayable government assistance	6,964	2,476	0
Long-term deferred government incentives	2,382	3,336	3,607



1. Please refer to "Non-GAAP and Other Measures" section

Other Corporate Highlights from Fiscal 2010

The following section is a summary of certain corporate highlights that are not specifically referred to in other sections of this Management's Discussion and Analysis. Scientific highlights and other corporate news are presented below under, "Segmented Performance".

On August 25, 2010, the Company reported:

Bioniche & University of Ottawa Sign Exclusive Global License Agreement for Natural Health Technology

On August 19, 2010, the Company reported:

Additional Phase III Clinical Trial with *Urocidin*[™] Expected to Commence in 2010

On June 23, 2010, the Company reported:

Bioniche & Trophogen Sign Exclusive Global Veterinary License Agreement for Superagonist Hormone Technology Platform

On June 17, 2010, the Company reported:

Bioniche Strengthens its International Patent Portfolio for its MCC & Oligonucleotide Technology Platforms

On June 2, 2010, the Company reported:

Bioniche Animal Health Partners with Bayer Australia to Distribute Livestock Product Line

On May 17, 2010, the company reported:

Bioniche Recognizes 10th Anniversary of Walkerton, Ontario Water Contamination Tragedy

On April 19, 2010, the Company reported:

Bioniche Reports FedDev Ontario Investment to Support Fermentation Scale-Up for New Vaccine Manufacturing Centre

On March 16, 2010, the Company reported:

Canadian Cattle Producers Are Willing to Make Changes to Prevent *E. coli* O157 Contamination on their Farms

On February 12, 2010, the Company reported:

Bioniche Achieves Two Additional Milestones Under Licensing Agreement; Endo Takes Up Global Rights

On January 29, 2010, the Company reported:

Bioniche *E. coli* O157 Vaccine Recognized in Prestigious Scientific Journal

On November 25, 2009, the Company reported:

Bioniche Strengthens the International Patent Portfolio for its MCC Technology Platform

On November 6, 2009, the Company reported:

Bioniche Reports Fiscal 2010 First Quarter Results and Achievement of First Milestone Under Licensing Agreement

The Company reported that it had met the obligations associated with the first milestone, triggering a US\$6.0M payment from Endo.

On September 21, 2009, the Company reported:

Bioniche Reports Fiscal 2009 Year-End Results

The Company announced that Mr. Nick Photiades was appointed to the Board of Directors as an independent Director. Further, the Company welcomed a new Chief Financial Officer: Mr. Brian Ford.

On August 24, 2009, the Company reported:

Bioniche Phase III Clinical Trial with *Urocidin*[™] Given Continued Green Light by DMC

On August 5, 2009, the Company reported:

Bioniche Announces Resignation of its CFO

On July 20, 2009, the Company reported:

Bioniche Repays Revolving Credit Facility

The Company reported that it had repaid its credit facility with Valens U.S. and associated fees, a total of \$5.8M [US\$5.2M].

*Valens financed the Company through a challenging time of corporate development, helping the Company to advance its bladder cancer technology to Phase III clinical testing and its *E. coli* O157 vaccine — Econiche[™] — to full Canadian license.*

On July 17, 2009, the Company reported:

Econiche[™] Vaccine Efficacy Summarized in July Issue of Foodborne Pathogens and Disease

On July 10, 2009, the Company reported:

Bioniche Life Sciences Inc. and Endo Pharmaceuticals Inc. Sign Licensing Agreement for *Urocidin*[™]

Business Strategy

Background and business model

The Company was founded by Graeme McRae as Vetrepharm, an Animal Health company, in 1979. At that time, the Company was located in London, Ontario. Mr. McRae believed that the major veterinary pharmaceutical companies were putting insufficient research efforts into alternatives to antibiotics as treatments for livestock disease. He believed that there had to be more suitable ways of treating veterinary diseases that did not have the problems associated with antibiotics, such as, leaving residues in the food chain and promoting the development of resistant bacteria species. Thus, Vetrepharm was established to research and develop such alternatives, and this commitment has remained throughout the Company's 31 years of existence. In the course of developing these technologies, the Company supported itself by developing a number of new product technologies, manufacturing these products and selling them to veterinarians.

This has proven to be a sustainable approach in managing the business, growth, scope of development and building shareholder value. Manufacturing and product sales have been a key component in providing stability to the business and its development activities. Consequently, the Company believes the best way to create long-term shareholder value is to generate increasing cash flows from operations as a result of registration and commercialization of internally developed products. While it is the Company's preference to participate as much as possible in the full life cycle of products developed internally, some projects benefit from alignment with marketing and commercialization partners, such as Endo for

*Urocidin*TM. Whenever possible, the Company will manufacture the products it develops for a far superior margin than would be available through conventional licensing agreements with external manufacturers and distributors. Currently, two major products developed internally (*Urocidin*TM and *Econiche*TM) are in their final stages of development and are advancing through the appropriate regulatory pathways, and the Company has plans to retain the manufacturing of these products.

Over the years, the Company has primarily raised equity to finance its development activities. Going forward, the Company's plan is to fund ongoing development from growing and sustainable operating results, and to fund the construction and development of manufacturing facilities using conventional long-term financial instruments, including government assistance where possible.

Goals and Objectives

The Company's goals and objectives are to execute its business strategy by:

1. Taking existing proprietary technologies and continue, through the product development program, to enhance their proven therapeutic value for human and animal use.
2. Working to develop these technologies to the point of commercialization, either alone or with strategic marketing partners.
3. Manufacturing as many products emerging from the product development program as possible to increase profit margins, protect the integrity of the Company's products, and enhance long-term shareholder value.

Fiscal 2010 Objectives	Status
<ul style="list-style-type: none"> Complete Phase III clinical trial with <i>Urocidin</i>TM in patients with non-muscle-invasive bladder cancer that is refractory (unresponsive) to the standard therapy. 	<ul style="list-style-type: none"> The Company has met this objective. The last patient participating in the first Phase III clinical trial received his/her final assessment in April, 2010.
<ul style="list-style-type: none"> Progress <i>Urocidin</i>TM development activities to achieve milestone revenue incentives as outlined in the agreement with Endo. 	<ul style="list-style-type: none"> Milestone incentives under the agreement total up to US\$110M. These are linked to the achievement of future clinical, regulatory, and commercial milestones. The Company achieved the first three milestones amounting to US\$14.0M during Fiscal 2010.
<ul style="list-style-type: none"> Secure a marketing partnership for the Company's bladder cancer technology outside North America or for the rest of the world. 	<ul style="list-style-type: none"> This objective has been met. Endo had an option to acquire the licensing rights to market and distribute <i>Urocidin</i>TM outside North America until July 10, 2010. In February, 2010, the Company announced that Endo has elected to exercise its option for exclusive rights to develop and market the product globally.

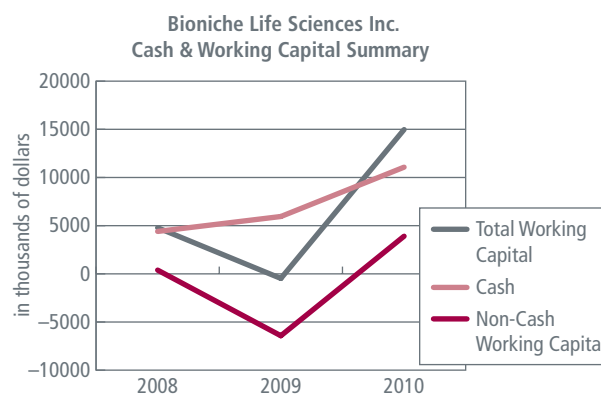
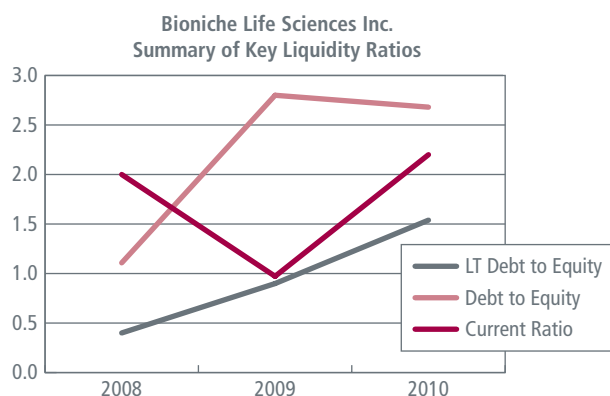
Fiscal 2009 Objectives	Status
<ul style="list-style-type: none"> Progress to a U.S. conditional license for the <i>Econiche</i>TM cattle vaccine. 	<ul style="list-style-type: none"> In February, 2008, the vaccine was granted eligibility for a conditional license in the U.S. In order to be granted this license, several steps had to be undertaken, including the production of three consecutive commercial batches of vaccine that are filled in an approved U.S. manufacturing facility and are proven to meet required specifications. In addition, in order to obtain the conditional license in the U.S., the Company was required to file a clinical trial plan to be completed over the next few years. The Company expects that a conditional license may be granted in the coming months.
<ul style="list-style-type: none"> Develop new banking relationships and establish credit facilities responsive to future credit requirements. 	<ul style="list-style-type: none"> Last year, due to financial market conditions, Valens U.S. informed the Company that it would like to end the existing revolving credit facility. In July, 2009, the Company repaid the outstanding credit facility with Valens U.S. and associated fees, a total of \$5.8M [US\$5.2M]. The Company is now assessing its future credit requirements with respect to planned operations and ongoing research and development efforts. The Company expects to establish appropriate new credit facilities by December 31, 2010.
<ul style="list-style-type: none"> Develop, build and enhance the product line for the Animal Health business unit. 	<ul style="list-style-type: none"> This unit has provided the core sources of revenue and cash flow for the Company for many years. New technologies and markets are continuously emerging and, consequently, some of the Company's products require updates to remain competitive. In addition, the Company is making investments to realize new market opportunities for both existing and new products.

Liquidity and Going Concern

The Company has incurred significant losses and has an accumulated deficit of \$96.9M as at June 30, 2010.

The Company enjoyed improved operating results, improved liquidity, and a stronger financial position over the course of Fiscal 2010. This has been driven principally by the signing on July 10, 2009 of the Agreement, as described above.

The Company had a cash position at June 30, 2010 of \$11.1M. This strong cash position resulted from cash generated by operations of \$16.6M, which includes the \$22.3M [US\$20M] up-front payment related to the Agreement as explained above and selling the U.S. licensing rights to an animal health product in July, 2009 for \$0.9M [US\$0.8M], offset by the cash used for repayment of the revolving credit facility and associated fees of \$5.8M [US\$5.2M], and the repayment of all overdue outstanding payables. In addition, the Company has earned the first three milestones under the already defined Agreement of \$14.8M [US\$14.0M].



In the past, the Company has financed its cash requirements primarily through the issuances of shares, product sales, investment tax credits, the sale of businesses or business units, royalties, government incentives, long-term debt issuances, and a revolving credit facility.

In addition to traditional sources of cash, the Company expects to finance many of its future expenditures by receiving certain payments from its licensing partner on accomplishing milestones related to the conduct of the *Urocidin*TM clinical program. Although the Company is confident that it will achieve these milestones, that it will successfully replace its revolving

credit facility, and that it will maintain a strong EBITDA before research and development expenditures in the Animal Health business unit, these events are dependent upon certain factors outside of the Company's control. If not achieved, the Company may be required to obtain additional financing or curtail its development activities and operations. Due to the uncertainty of future events, the Company has prepared its financial statements as at June 30, 2010 under the assumption that it will continue as a going concern as disclosed in note 1 to those financial statements.

WORKING CAPITAL ASSESSMENT

(expressed in thousands of Canadian dollars)

	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Mar-09	Dec-08	Sep-08	Jun-08	Mar-08	Dec-07	Sep-07
UNRESTRICTED Cash	11.1	15.4	14.3	13.5	5.9	2.9	5.6	4.3	4.4	8.8	6.6	8.0
Receivables	8.6	5.6	5.0	4.1	3.7	6.2	5.8	6.6	6.4	5.5	5.1	5.1
Inventory	6.7	7.1	6.6	6.0	5.4	6.6	6.0	4.9	4.7	4.9	5.3	5.5
	26.3	28.1	26.0	23.6	15.1	15.8	17.4	15.7	15.5	19.3	17.1	18.6
Less: Payables	(9.7)	(6.2)	(7.1)	(5.2)	(11.6)	(10.5)	(10.1)	(8.0)	(8.3)	(7.9)	(6.9)	(6.5)
Less: Revolver (not net of def. fin. costs)	—	—	—	—	(4.4)	(5.4)	(5.3)	(3.4)	(3.2)	(5.0)	(3.9)	(3.0)
Net balance	16.6	21.9	18.9	18.4	(1.0)	(0.1)	2.0	4.3	4.1	6.4	6.2	9.1

Results of Operations

The following table sets forth, for the periods indicated, the percentage of revenue represented by items in the Bioniche Life Sciences Inc. Consolidated Statements of Loss and Comprehensive Loss.

CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

(expressed in millions of Canadian dollars)

	Q4	2010		Q4	2009	
		YTD			YTD	
For the twelve-months ended June 30		\$	%		\$	%
Revenues	9.4	45.9	100%	9.3	33.3	100%
Expenses						
Cost of Sales	3.6	12.7	28%	3.9	14.4	43%
Administration	1.7	6.8	15%	2.3	7.0	21%
Marketing and Selling	1.8	6.3	14%	1.4	6.1	18%
EBITDA* before Research and Development	2.4	20.1	45%	1.8	5.8	17%
Net Research and Development	3.8	18.6	41%	2.4	11.6	35%
Interest, taxes, depreciation, amortization	0.7	3.2	7%	1.2	4.7	14%
Net income (loss) and comprehensive income (loss)	(2.1)	(1.6)	-4%	(1.7)	(10.5)	-32%

* EBITDA means "Earnings before interest, taxes, depreciation and amortization". For more information please refer to the section "Non-GAAP & other measures" below

Consolidated Revenue

The Company's consolidated revenue for Fiscal 2010 reached \$45.9M as compared to \$33.3M for Fiscal 2009, a 38% increase. The increase of \$12.6M is the result of \$14.8M milestone payments received in relation to the Endo agreement, as well as research collaborations with Endo of about \$1.8M, and \$1.4M amortization of the up-front payment, accounted for as deferred revenue and amortized over 15 years, which is the term over which the Company maintains substantive contractual obligations. This represents the first revenues realized from the Company's human health division. These gains were offset by a reduction in sales of Animal Health products of approximately \$6.3M, or 19%, as compared to product sales in Fiscal 2009. Sales performance for Animal Health was affected by the economic recession in certain markets, as well as some deterioration of the U.S. dollar over the year, which represents 52% of Animal Health sales denominations.

For the fourth quarter of Fiscal 2010, revenues overall are comparable to same period in Fiscal 2009, although the revenue mix has shifted between the Human Health and Animal Health divisions. Fiscal 2010 Q4 revenues include amortized licence and research collaboration revenues from Endo of \$0.4M and \$1M respectively, and Animal Health revenues of \$7.9M, a reduction of \$1.3M over the same period in Fiscal 2009 for the reasons previously described.

Cost of Sales

While cost of sales appears to have fallen substantially in relation to total revenues, such costs relate to Animal Health product sales only. During the year ended June 30, 2010, cost of sales fell by \$1.7M from Fiscal 2009, or 12%. This is consistent with the decline in sales over the same period.

For Q4, similar reductions to cost of product sales were experienced in Fiscal 2010 as for the year overall.

GEOGRAPHIC DISTRIBUTION OF CONSOLIDATED REVENUES BY BUSINESS UNITS

(expressed in millions of Canadian dollars)

	2010 Q4	2009 Q4	Growth	2010 YTD	2009 YTD	Growth
	\$	\$	%	\$	\$	%
For the three and twelve months ended June 30						
Animal Health – Canada	2.0	2.5	-21%	7.2	8.5	-16%
Animal Health – USA	4.5	5.1	-13%	14.1	18.3	-23%
Animal Health – Australia	1.1	0.7	57%	3.8	3.9	-3%
Animal Health – EU	0.3	0.9	-63%	1.8	2.6	-29%
<i>Sub Total - Animal Health</i>	7.9	9.2	-15%	26.9	33.3	-19%
Gain on sale of intangible assets	—	—		0.9	—	
Licensing and research collaboration	1.5	—		18.1	—	
Total reported revenues	9.4	9.2	2%	45.9	33.3	38%

Administrative Expenses

In Fiscal 2009, administrative expenses include approximately \$0.9M of non-recurring expense related to some strategic initiatives, and accordingly, recurring administration expenses have increased in Fiscal 2010 by approximately 10%. Due to financial pressures in Fiscal 2009, the Company took

several steps to cut expenditures and defer some administrative projects and activities. In Fiscal 2010, with the completion of the Endo agreement, the Company has been able to restore normal and sustainable levels of corporate services.

EXPENSES OTHER THAN RESEARCH AND DEVELOPMENT*(expressed in millions of Canadian dollars)*

For the three and twelve months ended June 30	Q4	2010		Q4	2009	
		YTD			YTD	
	\$	\$	%	\$	\$	%
Revenues	9.4	45.9	100%	9.3	33.3	100%
Expenses						
Cost of sales	3.6	12.7	28%	3.9	14.4	43%
Administration	1.7	6.8	15%	2.3	7.0	21%
Selling and Marketing	1.8	6.3	14%	1.4	6.1	18%
Sub-total	7.0	25.8	56%	7.5	27.5	84%
Non-cash and other items						
Amortization	0.5	2.0	4%	1.0	3.9	12%
Interest	0.2	0.7	1%	0.2	0.7	2%
Foreign Exchange	0.0	0.5	1%	(0.3)	(0.3)	
Sub-total	0.7	3.1	7%	1.0	4.4	13%
Total Expenses	7.7	29.0	63%	8.5	31.9	97%

Research and Development

Research and development expenditures increased in Fiscal 2010 by \$4.6M over Fiscal 2009, or 34%. This increase relates to ongoing expenditures for the *Urocidin*TM clinical development program, as well as the reintroduction of certain development programs in Animal Health that were deferred in Fiscal 2009 due to cash constraints.

The majority of research and development costs can be attributed to the ongoing Phase III clinical program for the Company's *Urocidin*TM bladder cancer treatment and to an increased focus on the development of Animal Health reproduction products and vaccines. Going forward, Endo has assumed financial responsibility for the external costs of clinical activities as they relate to *Urocidin*TM, and the Company intends to refocus its development activities for MCC on other indications.

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

For the twelve months ended June 30	Q4	2010		Q4	2009	
		YTD			YTD	
	\$	\$	%	\$	\$	%
Key Areas						
Animal Health	0.9	3.1	17%	0.5	1.9	14%
Food Safety	0.4	1.6	9%	0.2	1.6	12%
Human Health	3.4	13.2	74%	2.1	9.9	74%
Research and Development, Gross	4.7	17.9	100%	2.8	13.4	100%

Consolidated Net Loss and Comprehensive Loss

For the year ended June 30, 2010, the basic and fully-diluted loss per share totalled (\$0.02), compared to a loss per share of (\$0.15) for the corresponding period in Fiscal 2009 as a result of improved performance in Fiscal 2010. Total Common Shares outstanding at June 30, 2010 were 72,890,247, as compared to 71,681,147 for the corresponding period in Fiscal 2009.

EBITDA (before Research and Development)

EBITDA has increased significantly during Fiscal 2010 over Fiscal 2009, primarily due to milestone revenues recognized in 2010 of \$14.8M from Endo, as well as collaboration and amortization of license revenues of \$1.8M and \$1.4M, respectively. These increases were partially offset by lower margins on Animal Health sales.

CALCULATION OF EBITDA

(expressed in millions of Canadian dollars)

	2010		2009	
	Q4	YTD	Q4	YTD
For the three and twelve months ended June 30	\$	\$	\$	\$
Income (loss) before research and development	1.7	16.9	0.8	1.4
Add (deduct):				
Amortization	0.5	2.0	1.1	3.9
Financial expenses	0.2	0.7	0.2	0.7
Foreign exchange	0.0	0.5	(0.3)	(0.3)
EBITDA before research and development	2.4	20.1	1.8	5.8

Last Eight (8) Quarters Consolidated Results

The Company has continued to demonstrate improved results in Fiscal 2010 as compared to Fiscal 2009 on a quarterly basis. Q2 and Q3 of Fiscal 2010 reflect the impact of performance milestone revenues recognized upon achievement of certain activities by the Company.

LAST EIGHT (8) QUARTERS CONSOLIDATED RESULTS AT A GLANCE

(expressed in millions of Canadian dollars)

	2010				2009			
	\$	\$	\$	\$	\$	\$	\$	\$
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenues	9.4	15.6	13.8	7.1	9.2	7.4	8.6	8.1
Income (loss) before research & development	1.7	8.4	6.6	0.2	0.7	0.0	0.5	0.1
Net Income (loss)	(1.8)	4.4	2.7	(6.8)	(1.8)	(3.0)	(2.4)	(3.3)
Basic and fully diluted net income (loss) per share	(0.03)	0.06	0.04	(0.09)	(0.03)	(0.04)	(0.03)	(0.05)

Fluctuations in Consolidated Operating Results

The Company's consolidated results of operations are likely to fluctuate significantly from period to period in the future. It is anticipated that the quarterly and annual results of operations will be impacted for the foreseeable future by several factors, including the timing of clinical trials, the timing of regulatory approvals to market products, the progress and timing of expenditures related to commercialization efforts, the timing of revenues from product sales and, most significantly, the achievement of performance milestones. Due to these fluctuations, the Company presently believes that the period-to-period comparisons of its consolidated operating results are not a good indication of future performance, particularly with the closing of the July, 2009 Agreement described above.

Consolidated Balance Sheet Highlights

Assets

The Company's current assets at June 30, 2010 totalled \$27.4M, as compared to \$16.9M reported at June 30, 2009. The increased level of assets results primarily from the Company's signing of a partnership transaction for *Urocidin*[™], described above. Cash and cash equivalents, (including restricted cash for Fiscal 2009) totalled \$11.1M at June 30, 2010, as compared to \$7.2M at June 30, 2009.

Long-term assets at June 30, 2010 were \$24.7M, as compared to \$17.8M reported at June 30, 2009. This increase of \$6.9M is primarily due to the investments made in constructing the Animal Health & Food Safety Vaccine Manufacturing Centre in Belleville, Ontario.

Liabilities and Shareholders' Equity

At June 30, 2010, the Company's net working capital totalled \$16.3M, excluding the current portion of non-refundable deferred licensing revenue, as compared to negative working capital of (\$0.5M) at June 30, 2009. Shareholders' equity at June 30, 2010 totalled \$8.5M, as compared to \$9.1M at June 30, 2009.

Long-term liabilities at June 30, 2010 totalled \$11.9M, excluding non-refundable deferred licensing revenue of \$19.4M, which compares to \$8.2M reported at June 30, 2009. The increase reflects the long-term portion of the required repayment of government assistance to the Industrial Technologies Office (ITO, formerly TPC) of \$3.1M, less repayments of capital leases and long-term debt. The up-front payment related to the licensing agreement with Endo is reflected as non-refundable deferred licensing revenue, the current portion being \$1.5M and the long-term

portion being \$19.4M. The total amount received was \$22.3M, which will be recognized in income over 15 years from the date of the Agreement (July 10, 2009), which is the term over which the Company maintains substantive contractual obligations.

Cash Flow Statement Highlights

The Company's cash flows provided from operations for Fiscal 2010 was \$16.6M, as compared to cash flows used by operations of \$3.0M in the same period in Fiscal 2009. This increase is primarily supported by the achievement of the first three milestones under the License, Development and Supply Agreement with Endo, amounting to \$14.8 [US\$14.0M], and the up-front payment of \$22.3M [US\$20.0M] under the same agreement.

The Company's investing activities used cash of \$6.6M during Fiscal 2010, primarily on construction costs of \$7.8M for the Vaccine Manufacturing Centre in Belleville, Ontario, offset by government assistance and proceeds from the sale of a product license.

Segmented Performance

Segmented financial information analyzes the operations of the Company according to its business segments:

Human Health Segment

During the year ended June, 2010, important efforts were made by the Company to advance its Phase III clinical development program, which is being conducted in partnership with Endo over the next several years. Endo has effectively assumed responsibility for all external clinical development costs for *Urocidin*[™] going forward.

For the year ended June 30, 2010, licensing revenue of \$1.4M [nil in 2009] was recognized, reflecting the amortization of the up-front payment by Endo upon signing of the *Urocidin*[™] Agreement. The total received, \$22.3M, will be recognized over 15 years. Milestone revenue of \$14.8M [US\$14.0M] earned under the same agreement was also recognized during the current year.

Net research and development expenses for the year ended June 30, 2010 totalled \$14.3M, compared to \$8.4M reported in Fiscal 2009. The overall increase of \$6.0M is primarily attributed to the ongoing Phase III *Urocidin*[™] clinical development program. In addition, approximately \$1.8M of *Urocidin*[™]-related development expenditures has been recovered from Endo and is presented as research collaborations.

The signing of the Agreement for *Urocidin*[™] on July 10, 2009 triggered the requirement to make annual cash payments to the Industrial Technologies

Office (ITO, formerly TPC) of Industry Canada of \$1.0M for five years, commencing no earlier than September, 2010. The fair value of this repayment has been recorded as repayable government assistance in the amount of \$3.9M.

Government incentives for the year ended June 30, 2010 totalled \$2.6M, which compares to \$1.5M recorded in the same period in Fiscal 2009. The increase relates to the recovery of increased development expenditures in Fiscal 2010 under certain government assistance programs, described fully in note 11 of the Annual Consolidated Financial Statements.

Animal Health Segment

Animal Health product sales were \$27.0M for the year ended June 30, 2010, as compared to \$33.3M for the same period in Fiscal 2009. This 19% decrease is the result of sales promotions in the last quarter of Fiscal 2009, recessionary conditions in certain markets, and the increase in the value of the Canadian dollar versus the U.S. dollar over the course of the 2010 fiscal year. In the first quarter of Fiscal 2010, the Animal Health segment realized a gain on the sale of a regulatory registration in the United States for *Ketamine* for proceeds of \$0.9M.

Expenses incurred during the year ended June 30, 2010 totalled \$19.3M, compared to \$21.1M reported in the same period in Fiscal 2009. This is the result of lower sales levels translating to lower cost of sales and to a reduction in marketing and selling expenses due to personnel changes.

Net research and development expenses for the year ended June 30, 2010 totalled \$3.1M, as compared to \$1.8M in the same period in Fiscal 2009. This increase is the result of increased focus on the development of live-stock reproduction products and vaccines.

Food Safety Segment

The Company continues its marketing efforts and is receiving strong indications of support, particularly in the Canadian provinces of Ontario and Québec. The Company is continuing with its plans to build a vaccine manufacturing facility to accommodate large-scale manufacturing production of *Econiche™* and other food safety and animal health vaccines. The facility is expected to be completed by the end of March, 2011.

Funding for the vaccine plant expansion comes in part from the Ontario Ministry of Economic Development and Trade's Advanced Manufacturing Investment Strategy program, which is contributing \$10.0M in the form of a loan based on a percentage of eligible expenditures incurred. At June 30, 2010, \$1.0M was advanced under this program. The Department of Agriculture and Agri-Food (Canada)'s Agri-Opportunities Program is also contributing

\$5.0M in the form of a loan based on a percentage of eligible expenditures incurred. At June 30, 2010, \$0.7M was advanced under this program. The Industrial Technologies Office (ITO) of Industry Canada is providing funding of \$5.0M in the form of a repayable loan. A further \$5.0M has been secured in the form of a loan from the Business Development Bank of Canada, however, remaining loan disbursements of \$3.3M will be made only as the Company makes certain qualifying expenditures.

Expenses incurred during the year ended June 30, 2010 totalled \$1.9M, as compared to \$1.5M in the same period in Fiscal 2009. The Company is continuing its education and awareness program focused on the dangers of *E. coli* O157 and the importance of food and environmental safety. Assistance with funding for market development related to the Company's *E. coli* O157 cattle vaccine continues to come from the Rural Economic Development ["RED"] Program in the form of a \$2.0M grant based on eligible expenditures. As at June 30, 2010, the Company has recognized \$1.7M of this grant, less a 10% holdback receivable that has been discounted using a discount rate of 5.69%. The eligible amount less the discount has been netted against the related marketing expenses.

This segment incurred gross research and development expenses of \$1.2M and \$1.3M for the fiscal years ended June 30, 2010 and 2009 respectively. The Company has continued to pursue its development efforts while awaiting product approval from the U.S. regulator.

Liquidity and Capital Resources

Financial Position and Cash Flow

At June 30, 2010, the Company had approximately \$11.1M in cash and cash equivalents, balances primarily provided from operations for the year, including the up-front payment of US\$20M and milestone payments of US\$14M from Endo. In the past, the Company has financed its expenditures primarily through public and private placements of Common Shares, the issuance of debt instruments, and the receipt of government incentives earned on eligible scientific expenditures. The operations of the Company's commercial division (Animal Health) have been financed through this division's own internally generated cash flows, through the use of commercial banking facilities, and through capital leases with equipment vendors. The Company will continue to use these sources of financing as provided by operations or as new credit lines and long-term debt facilities become available. Funding from operations includes anticipated milestone revenues over the next several months, which will be used to finance ongoing internal development commitments related to the Phase III clinical program in bladder cancer and other human

health indications. As the milestones and debt facilities are dependent on a number of factors outside of management's control, such as, the outcome of future events and changing market conditions, there is uncertainty concerning the Company's ability to continue as a going concern. Please refer to note 1 of the Company's Annual Consolidated Financial Statements.

The Company was able to advance its key development platforms in both Food Safety and Human Health for the year ended June 30, 2010 with cash provided from the Endo agreement without incurring any additional monthly burn (consolidated cash flow used in operations) during Fiscal 2010, as compared to a monthly burn of approximately \$0.2M during Fiscal 2009.

To address the Company's capital needs and to strengthen its consolidated financial position in the past, prior to the signing of the Agreement, the Company completed the following transactions:

- On **September 7, 2007**, the Company announced a \$2M grant from the Rural Economic Development (RED) Program of the Ontario Ministry of Agriculture, Food and Rural Affairs. The grant is based on a percentage of eligible expenditures related to marketing of the *E. coli* O157 cattle vaccine.
- On **December 18, 2007**, the Company announced that it would receive a \$10M loan from the Ontario Ministry of Economic Development and Trade (MEDT)'s Advanced Manufacturing Investment Strategy (AMIS) program. This loan is in support of the Company's Animal Health & Food Safety Vaccine Manufacturing Centre scale-up in Belleville, Ontario, Canada, and is based on a percentage of eligible expenditures.
- On **December 20, 2007**, the Company announced it would receive a \$5M loan from the new Agri-Opportunities Program of the Department of Agriculture and Agri-Food (Canada) (AAFC). The loan is based on a percentage of eligible expenditures and supports the above-mentioned Vaccine Manufacturing Centre scale-up.
- On **December 21, 2007**, the Company announced an amendment to its revolving credit facility, resulting in a borrowing limit of US\$5.5M.
- On **February 8, 2008**, the Company entered into a ten-year term loan agreement with the Business Development Bank of Canada (BDC) for up to \$5M to support the above-mentioned Vaccine Manufacturing Centre scale-up.
- On **March 27, 2008**, the Company announced the conversion of a portion of its revolving credit facility, issuing 2,671,900 Common Shares, which resulted in additional borrowing capacity of \$1.8M.
- On **June 25, 2008**, the Company amended a pre-existing \$7.6M contribution agreement with the Industrial Technologies Office of Industry

Canada that will support the above-mentioned Vaccine Manufacturing Centre scale-up.

- On **September 9, 2008**, the Company announced the conversion of a portion of its revolving credit facility, resulting in the issuance of approximately 4.6M Common Shares and the availability of up to \$2.0M in additional borrowing capacity.
- On **March 2, 2009**, the Company announced that it had amended the maturity date of its existing secured revolving credit facility with Valens U.S. This extension was provided to the Company in order to allow it time to identify new banking partner(s) after Valens decided to withdraw its credit due to recent market conditions. The original revolving credit facility was established in 2005. There were no fees or penalties resulting from this amendment.
- On **July 20, 2009**, the Company repaid its credit facility and associated fees with Valens U.S., a total of US\$5.3M (\$5.8M).
- In a subsequent event in Fiscal 2009, on **July 23, 2009**, the Company sold its U.S. license for a veterinary anaesthetic product (*Ketamine*) to Bioniche Teoranta for total consideration of US\$0.8M (\$0.9M). The Company received US\$0.5M (\$0.6M) in cash at closing, along with US\$251,361 (\$275,000) in debt forgiveness.

Treasury Operations and Restricted Cash

The Company's treasury policy is to invest cash that is not required immediately into short-term instruments with an investment strategy based on capital preservation. Such investments are primarily made in guaranteed investment certificates (GICs) and high-interest savings accounts, both of which are issued by Canadian chartered banks. At June 30, 2010, approximately \$6.8M was held in high-interest savings accounts.

The Company reduced its restricted cash at June 30, 2010 to nil. Previously, this funding was received in connection with the government assistance loan agreements referred to above. The government agencies in question agreed to accelerate disbursements under the agreements in advance of claims submitted. The advance disbursements were only to be used for expenditures related to the construction of the Animal Health and Food Safety Vaccine Manufacturing Centre in Belleville, Ontario. Consequently, these advances were completely applied by June 30, 2010.

Related Party Transactions

On June 3, 2005, the Company entered into a ten-year lease for a facility located at 275 Labrosse Avenue in Pointe-Claire, Québec. The facility is leased to the Company from a company owned and controlled by Graeme McRae, the Company's Chairman, President, and Chief Executive Officer. Under the

terms of the amended lease, the Company had the option to purchase the facility by May 28, 2011 by assuming the balance of the loan outstanding.

This transaction was recorded as a capital lease obligation as disclosed in note 10 of the Company's 2010 Annual Consolidated Financial Statements. The facility consists of 14,000 square feet and is expected to be used for additional manufacturing space in the future. This facility will allow the Company to expand the production capacity of its existing MCC manufacturing to meet the projected eventual market demand for *Urocidin*[™].

The Company paid two directors \$82,000 [2009 – one director \$70,000] in consulting fees and purchased inventory items from a company owned by a director in the amount of \$15,000 [2009 – \$5,000]. The Company received payment for services provided to a company owned by a director of \$88,000 [2009 – \$45,000].

Off-Balance Sheet Arrangements

To date, the Company has not had any relationships with unconsolidated entities or financial partnerships, such as, those referred to as "structured finance" or "special purpose" entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than the Company's operating leases and the commitments disclosed therein, the Company has no other off-balance sheet transactions.

Outstanding Common Shares

The Company has total Common Shares outstanding at September 10, 2010 of 72.5M. In addition, the Company has 1.7M outstanding Warrants and 5.5M outstanding Options, exchangeable for one Common Share upon exercise. The Preferred Shares Series II with conversion rights are exchangeable for a maximum of 6.5M Common Shares. On a fully diluted basis, the equivalent number of Common Shares outstanding would be 85.9M.

Critical Accounting Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). The Company has identified the following accounting policies that it believes require application of management's most subjective judgments, often requiring the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. The actual results could differ from these estimates and such differences could be material.

The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including cash requirements, by assessing planned research and development activities and general and administrative requirements, the retention of key personnel, required clinical trial activity, market need for its drug candidates, and other major business assumptions.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts related to its accounts receivable. Accounts receivable are reviewed on a regular basis to determine if any receivables have a high risk of being uncollectible, and these are included in the allowance. Based on the information available, the Company believes the allowance for doubtful accounts is appropriate. However, actual write-offs might exceed the recorded allowance.

Provision for Inventory Obsolescence

Provisions for inventory are charged against income when it is determined that specific inventory items do not meet the defined quality and regulatory requirements for sale. The Company does not take general provisions for inventory obsolescence. The Company regularly reviews its inventories for obsolescence and valuation issues. Should selling prices and demand for inventory decline, additional provisions for obsolescence and valuation may be necessary. Provisions for inventory obsolescence require the Company to make a number of estimates. Inventory is reviewed on a product-by-product basis, and any valuation allowances are written off to cost of sales.

Inventories are valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis. Cost is comprised of direct materials, direct labour and an overhead allocation.

Revenue Recognition

Product revenue is recognized when the product is shipped to the Company's customers, provided the Company has not retained any significant risks of ownership or future obligations with respect to the product shipped, prices are fixed or determinable, and collection is reasonably assured.

Interest income is accrued as it is earned.

Revenue arrangements from research and development collaborations, and licensing arrangements with multiple elements, are reviewed in order to determine whether the multiple elements can be divided into separate units of accounting, if certain criteria are met. If separable, the consideration

received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

Licensing revenue — For up-front, non-refundable licensing payments received by the Company, revenue is deferred and recognized on a straight-line basis during the term over which the Company maintains substantive contractual obligations. In the case of the up-front payment under the Agreement, this is accounted for under deferred revenue over 15 years, which is the term over which the Company maintains substantive contractual obligations. For any portion of an up-front licensing payment that is subject to a refund, the revenue is deferred. Once the refund condition lapses, revenue is recognized on a straight-line basis during the term over which the Company maintains substantive contractual obligations. Milestone payments are immediately recognized as licensing revenue when the underlying condition is met; the milestone is not a condition to future deliverables; and collectability is reasonably assured. Amounts received in advance of recognition are included in deferred revenue.

Research collaborations — The Company recognizes revenue from research agreements as the contracted services are performed in accordance with the terms of the specific agreements.

Refundable Investment Tax Credits

The Company incurs research and development expenditures which are eligible for refundable provincial investment tax credits. The investment tax credits recorded are based on estimates of amounts expected to be recovered and are subject to audit by the taxation authorities. Accordingly, these amounts may vary. The amount of refundable investment tax credits receivable as at June 20, 2010 was \$0.1M (\$0.1M at June 30, 2009).

Valuation Allowance on Future Tax Assets

The Company recorded a valuation allowance on future tax assets related primarily to operating losses, as well as research and research expense carry-forwards. The related tax benefits are not likely to be realized based upon the Company's historic results and estimated future taxable income and tax planning strategies in the related jurisdictions. However, the implementation of future tax planning strategies or the generation of future taxable income in these jurisdictions could result in the recognition of a portion or all of these carry-forwards, which could result in a material increase in the Company's results of operations through the recovery of future income taxes.

Stock-Based Compensation

The Company has a stock-based compensation plan for executives, employees and consultants, and has applied the fair value method of accounting. The fair value of Stock Options granted is determined at the measurement date using the Black-Scholes Option pricing model, and expensed over the vesting period of the Options, with a corresponding increase to additional paid-in capital. Assumptions that affect the application of the fair value method include the determination of the volatility of the Company's share price and the expected life of the Options issued.

Assessment of Impairment of Goodwill and Long-lived Assets

The assessment of the impairment of goodwill and long-lived assets requires the use of careful judgment and significant estimates, including those related to unit sales, gross margins, cost of sales, market size and penetration, sales and marketing costs, etc., and their expected timing. Goodwill is tested annually, and long-lived assets are tested when indicators of impairment are present. During the years ended June 30, 2010 and 2009, the Company did not record any long-lived asset or goodwill impairment losses.

Changes in Accounting Policies and Recent Accounting Pronouncements

In February, 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, *Goodwill and Intangible Assets*. Section 3064 replaces Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*, and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This standard is effective for the Company's interim and annual consolidated financial statements beginning on July 1, 2009. Application of these new pronouncements has not had any impact in the Company's consolidated financial statements.

In May, 2009, the CICA amended Section 3862, *Financial Instruments — Disclosure*, to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosure. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements for financial assets and financial liabilities that are carried at fair value. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant inputs are observable, either directly or

indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to Section 3862 are effective for the Company's consolidated financial statements as at June 30, 2010. The new disclosures are included in note 15 of the Fiscal 2010 Annual Consolidated Financial Statements.

The CICA issued Handbook Sections 1582, *Business Combinations*, which replaces Section 1581, *Business Combinations*; 1601, *Consolidations*; 1602, *Non-controlling Interests*; and 1625, *Comprehensive Revaluation of Assets and Liabilities*. These standards are effective for the Company's interim and annual consolidated financial statements beginning on July 1, 2011, with earlier application permitted.

The suite of business combinations standards (CICA 1582, 1601 and 1602) was harmonized with the converged IASB and the FASB standards on business combinations and with their guidance on accounting for non-controlling interests. In conjunction with these changes, amendments were made to CICA 1625 and CICA 3251 to remove guidance no longer applicable and to make these standards consistent with the suite of business combinations standards.

International Financial Reporting Standards (IFRS)

The CICA will converge Canadian GAAP with International Financial Reporting Standards ["IFRS"] over a transition period to end in 2011. Beginning in Fiscal 2012, the Company will fully adopt IFRS including restated comparatives for 2011.

The Company's IFRS convergence project is led by its Chief Financial Officer, and an external resource has been engaged to assist with certain aspects of the project and advise management. The Company's audit committee receives quarterly updates from management. The Company's IFRS conversion project consists of three phases: Diagnostic, solution development, and implementation and execution.

Although many of the differences between IFRS and Canadian GAAP are not expected to have a material impact on the Company's financial results or financial position, the Company has not yet determined the full impact of the Company's convergence to IFRS.

In the second quarter of Fiscal 2010, with the assistance of external experts in IFRS, the Company completed a diagnostic study of the conversion of its consolidated financial statements to IFRS. This study and resulting report identify the principal differences in the Company's records between existing Canadian GAAP and IFRS standards and evaluate their impact on business

processes and information systems. They also assess the complexity of preparations and implementation, and identify resource requirements in support of the conversion.

While the Company expects a reasonable degree of impact in many areas related to reporting, the Company's view of the key areas where changes in accounting policies are expected that will likely impact the Company's consolidated financial statements are listed below with comments. The list and comments should not be regarded as a complete list of changes that will result from the transition to IFRS:

1. **Financial statement presentation and disclosures** — After the diagnostic, the Company prepared evaluations of significant accounting components and is in the process of preparing a comparative set of financial statements that contrasts IFRS against current Canadian GAAP, such that the additional disclosure requirements and options available on first-time adoption of IFRS can be fully examined and evaluated. The Company is also beginning the process of identifying additional data that management will require from the Company's systems. It is in the process of completing the implementation of an upgraded financial management system and an updated chart of accounts (particularly for capital assets) that will better allow the Company to supply the data required to prepare IFRS-compliant financial statements, including the preparation of comparative figures. The preparation of IFRS-compliant financial statements is not anticipated to require running a parallel general ledger.

2. **Matters relating to first-time adoption of IFRS** — International Accounting Standard ("IAS") 1 provides guidance on the general principles underlying the preparation of financial statements. IFRS requires greater transparency and more information in the notes to the financial statements, combined with many additional disclosures which are required by other IFRS standards. Examples of specific disclosures are:

- Upon transition to IFRS, a note describing the accounting options under IFRS 1 and choices made will be required in the financial statements.
- Note 1 – Accounting policies will require more details, especially in the areas of "determination of fair value", "impairment of assets", "related party transactions" and "leasing".

Adoption of IFRS will provide the Company with an opportunity to redesign its financial statements, benchmark with other industry leaders and provide better information for the users of the financial statements. Additional disclosure will impact the manner in which the Company's financial statements and results are interpreted by the users. To take one example affecting the notes, in the case of asset impairments, it will be necessary to educate investors and other readers

of financial statements to interpret the results correctly as significant disclosure is required.

- Perform benchmarking activities comparing the Company's financial statements to others in its industry.
- Complete the IFRS financial statement disclosure checklist to establish what additional data requirements the Company will be required to maintain and disclose.
- Re-draft the Company's consolidated financial statement template to comply with the requirements of IAS 1.

3. **Asset impairment considerations and measurement methods**

Impairments under IAS 36, "Impairment of Assets", are based on discounted cash flows. Under GAAP, if an asset's estimated undiscounted future cash flows are below its carrying amount, a write-down is required, which is determined by the amount that the carrying amount exceeds fair value. IFRS does not contain an undiscounted impairment test. In the event of an impairment trigger, this may result in write-downs where carrying values of assets were previously supported under GAAP on an undiscounted cash flow basis, but are not supported on a discounted cash flow basis.

Under GAAP, impairments are not reversed. Under IAS 36, a change in circumstances that results in an impairment of property, plant and equipment would require a re-determination of the amount of the impairment, with any reversal being recognized into income to the extent that the asset had been previously impaired.

4. **Property, plant and equipment** — IAS 16, "Property Plant and Equipment" and GAAP contain the same basic principles, however, there are some differences. IFRS requires that significant parts of an asset be depreciated separately. IFRS also permits property, plant and equipment to be measured using the fair value model or the historical cost model. IFRS 1 contains an elective exemption where an entity may elect to reset as the new cost basis for property, plant and equipment, its fair value at the date of transition. The Company is evaluating which option on which to base the opening valuation, and will report its final approach in the coming quarters.
5. **Share-based payments** — IFRS 2, "Share-based Payments", is substantially converged with Canadian GAAP. Canadian GAAP allows the use of either the straight-line or the accelerated methods to amortize graded-vesting features; the Company uses the straight-line method for equity-classified awards issued to employees. Under IFRS, only the accelerated or graded vesting methods are allowed. The Company is still evaluating which approach to adopt. Canadian GAAP permits

companies to either estimate forfeitures at the time of grant, or record the entire expense as if all Options vested at the time of grant and record forfeitures as they occur. IFRS 2 requires companies to estimate the forfeiture at the time of grant. These differences are expected to impact the accounting of the Company's incentive plans.

6. **Revenue and the Agreement with Endo** — Under Canadian GAAP, the Company uses EIC-142, "Revenue Arrangements with Multiple Deliverables", to account for the up-front payment received from the Agreement with Endo. As a result, the Company defers the amount of the up-front payment from its partner on the balance sheet and amortizes it over 15 years, which is the term over which the Company maintains substantive contractual obligations. Under IFRS, revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognized on the bases set out in paragraph 30 when:

- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The amount of the revenue can be measured reliably.

Royalties accrue in accordance with the terms of the relevant agreement and are usually recognized on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognize revenue on some other systematic and rational basis.

Under IAS 18, the Company may account for the entire up-front payment as revenues if certain criteria are met, i.e., no future performance obligation, remaining obligations or contingent future events.

7. **Leases** — The International Accounting Standards Board and Financial Accounting Standards Board in the United States have commenced a joint project on lease accounting that is expected to result in a fundamental change in accounting for leases by both lessors and lessees. The two Boards are considering the right-of-use model, in which: (a) The lessee recognizes as an asset its right to use the leased item and as a liability its obligation to pay for that item; and (b) The lessor recognizes as an asset its right to receive payments from the lessee and its residual interest in the leased item at the end of the lease term. The adoption of the right-of-use model would result in significant differences in the accounting for leases. The right-of-use model is based on the premise that, once the physical item has been delivered, the lessee has an unconditional right to use that item during the lease term. Consideration of the right-of-use model would effectively bring all leases, including leases currently accounted for as operating leases, on the balance sheet. A liability for obligation to make payments over the lease term would represent a financial liability. The proposed model remains under discussion, with timing of a final standard uncertain.

8. Activity plan for IFRS conversion

Key Activities	Key Milestones	Current Status
Accounting policies and financial statement preparation		
<ul style="list-style-type: none"> Identify differences between Canadian GAAP and IFRS. Evaluate and select one-time and ongoing IFRS policies. Benchmarking findings with peer companies. Develop financial statement format including notes to the financial statements. Quantify the effects of conversion to IFRS. 	<ul style="list-style-type: none"> Assessment and quantification of the effects of conversion to be completed in the second quarter of Fiscal 2011. Draft financial statements and format for notes to the financial statements to be completed in the second quarter of Fiscal 2011. Final selection of IFRS accounting policies to be completed in the third quarter of Fiscal 2011. 	<ul style="list-style-type: none"> Completed a diagnostic study that identified the key areas of difference between current practice and IFRS. In-depth analysis of issues and accounting policy choices is currently underway. Acquired research tools to assist in benchmarking industry and peer practices with respect to IFRS. Third-party experts are providing input and assistance related to implementation.
Accounting systems		
<ul style="list-style-type: none"> Identify and address changes to accounting systems required to comply with IFRS, including development of comparative information. Implement required changes. 	<ul style="list-style-type: none"> Select and implement tools and solutions in support of IFRS in the third quarter of Fiscal 2011. Complete testing and remediation of changes to system in the fourth quarter of Fiscal 2011. 	<ul style="list-style-type: none"> The Company is currently upgrading its accounting system to a version that can be supported for IFRS considerations. Additional modules related to Property Plant and Equipment and Enterprise Asset management have been licensed, and progress on implementation will be presented in future MD&As.
Control environment		
<ul style="list-style-type: none"> Confirm that business processes and controls are IFRS compliant. Identify and implement changes required to support Disclosure Controls and Procedures ("DCP"). Identify and implement changes required to support Internal Controls over Financial Reporting ("ICFR"). 	<ul style="list-style-type: none"> Any changes are required to be implemented in the fourth quarter of Fiscal 2011. Update internal senior management certification processes for the fourth quarter of Fiscal 2011. Update the CFO and CEO certification processes for the fourth quarter of Fiscal 2011. 	<ul style="list-style-type: none"> Evaluation of current practices with respect to IFRS is underway, and is being integrated to current processes over the evaluation and testing of DCP and ICFR.
Training		
<ul style="list-style-type: none"> Define and introduce an appropriate level of expertise for each of the following: <ul style="list-style-type: none"> Financial reporting and accounting staff Senior management Audit committee 	<ul style="list-style-type: none"> Complete training in the third quarter of 2011. 	<ul style="list-style-type: none"> Training has been provided to the Audit Committee and Senior Management of the accounting group. Progress of additional training efforts will be reported in future MD&As.
Other business activities		
<ul style="list-style-type: none"> Identify IFRS impact on external contractual arrangements, financial covenants, and employee compensation plans. Integrate IFRS related communication in support of investor relations, MD&A, and, and other external communications. 	<ul style="list-style-type: none"> Report progress of IFRS conversion in MD&A on a quarterly basis. Complete review of material contracts and evaluate IFRS impact on accounting in the second quarter of Fiscal 2011. Support for investor relations with respect IFRS related queries and communications to be in place by the end the first quarter of Fiscal 2011. 	<ul style="list-style-type: none"> IFRS conversion progress reporting has now been integrated with the process for building and completing the MD&A. Contract review is underway — currently, we have identified some contracts of interest in terms of revenue recognition differences, and will report further progress and the impact of such differences in future MD&As.

Going forward, in future quarterly and annual reports, the Company will provide updates on its IFRS activities, including its progress on the activity plan, outlines of key differences between current practice and IFRS, and, when possible, illustrative disclosures and financial statement account reconciliations. The Company also intends to perform an evaluation of the impact of the adoption of IFRS on material contracts, compensation arrangements and business activities that rely on financial information during the remainder of 2010, as well as evaluating the impact of IFRS on its control environment, and system and business processes.

Non-GAAP & Other Measures

The following measures included in the MD&A 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: Means "Earnings before Interest, Taxes, Depreciation, Amortization and foreign exchange". 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 financial performance of the Company's operations.

Burn Rate: Means consolidated 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).

Net working capital: Means current assets minus current liabilities, excluding the current portion of non-refundable deferred licensing revenues.

Effectiveness of Disclosure Controls

In accordance with National Instrument 52-109 — "Certification of Disclosure in Issuers' Annual and Interim Filings" ["National Instrument 52-109"], the Company is responsible for establishing and maintaining internal control over its financial reporting, which is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements in accordance with Canadian GAAP. Due to the inherent limitations in any control system, internal control over financial reporting may not prevent or detect all material misstatements. Also, any conclusions on the effectiveness of a system of internal control in the future are subject to risk, as the system may be or become inadequate for many reasons, including due to

changes in business conditions, personnel changes and/or the impact of other risks and uncertainties on internal controls.

Management has used the framework of the Committee of Sponsoring Organizations of the Treadway Commission ["COSO"] to evaluate the effectiveness of the Company's internal control over financial reporting.

The Chairman, President and Chief Executive Officer and the Chief Financial Officer, together with management, completed the documentation and preliminary evaluation of the effectiveness of the Company's disclosure controls and procedures ["DCP"] and internal controls over financial reporting ["ICFR"] at June 30, 2010. Over the course of the fourth quarter of Fiscal 2010, the key controls identified in the documentation were tested and evaluated. As a result of this testing, the Company has discovered a number of areas where significant improvements and updates should be introduced and implemented, including the documentation of controls. None of the observations or results indicated a material weakness in either DCP or ICFR for the year ended June 30, 2010.

The Company plans to continue to review and make the necessary changes to its ICFR policies and procedures, including policy development and implementation, the hiring of additional resources in the accounting and finance department and implementation of upgrades to the accounting systems. These new resources, combined with changes in the Company's financial condition, should result in improvements in its review and approval process, particularly the financial statement close process.

The Company expects to implement a number of improvements over the course of Fiscal 2011 to address those necessary to maintain DCP and ICFR through the Company's convergence with IFRS.

For example, during the fiscal year ending June 30, 2010, the Company has established more formal communication and internal certification processes, as well as improvements to accounts payable processes. These changes were adopted to ensure all matters of financial significance are brought to the attention of accounting and reporting staff on a timely basis. While these changes have certainly improved communication processes, additional opportunities to improve these processes have been identified through the review, testing and evaluation of controls, and the Company will implement improvements.

Risks and Uncertainties

Approach to Risk Management

The Company's business activities expose it to a wide variety of risks. The Company's goal is to manage these risks so that it is reasonably protected

from an unacceptable level of earnings or financial exposure while still enabling business development through its commercialization activities. The Company has developed a risk management oversight structure and an internal reporting structure to monitor and manage the risks arising from its business activities, the markets in which it operates, and the regulatory and political environments and structures with which the Company interfaces internationally.

The Company's risk management processes include the following pathways to oversight of its principal risks:

The Board of Directors provides for the stewardship of the Company, reviews and establishes policies and procedures, and receives quarterly comprehensive management reports outlining progress and status of all critical activities and associated risks. The Board of Directors also undertakes to understand the key risks of the Company and directs management to address any risks with which it believes are not in the best interests of the Company and shareholder value creation.

The Audit Committee ("AC"), established by the Board of Directors, provides assistance to the Board of Directors in fulfilling its oversight responsibility relating to the integrity of the Company's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the external auditors' qualifications, terms and conditions of appointment, including remuneration, independence, performance and reports, and the legal and risk compliance programs as established by management and the Board of Directors.

Controls Aimed at Mitigating, Monitoring and Managing Risks

The Company's risk controls have several key components:

ORGANIZATIONAL COMMITMENT TO CORE VALUES

Every corporate culture is unique. The Company strives to foster beliefs and actions that are true to, and respectful of, its stakeholders and the community at large. The Company does this by investing in communities where its employees live and work, concentrating on operating and growing sustainability, putting safety first, and being responsible to the many groups and individuals with whom it comes into contact. The Company's activities and approach to business are consistent with its "Code of Conduct" and ethics policies.

POLICIES

The Company maintains a set of enterprise-wide policies that have been established to address key risks. These policies establish delegated

authorities and limits for business transactions, as well as allow for an informed approval process. The Company performs periodic reviews and audits to ensure compliance with these policies.

REPORTING

The Company provides quarterly progress reports, together with risk exposures, to key decision-makers including the Board of Directors and senior management. This reporting includes analysis of emerging risks, existing risk exposures, activities carried out in relation to those risks, and the adopted or recommended course of action to mitigate the existing level of risk. This quarterly reporting provides for effective and timely risk management and oversight.

COMPLAINTS PROCEDURE

Any director, officer or employee who has any concern or complaints regarding accounting, internal control or auditing matters, any potential violations of law or regulatory provisions, unethical or illegal conduct may, in accordance with the Code of Ethical Conduct and Business Practices, make an anonymous submission through the Bioniche portal pursuant to the Company's policy on Reporting of Unlawful Activity. The concern/complaint will be anonymously directed to the Lead Director of the Corporate Governance and Nominating Committee as well as an appointed representative of the Company's Legal Department. Such submissions are not traceable to the sender by either the Company or its IT department.

For shareholders and those without access to the Bioniche portal, submissions may be made in writing, marked confidential, and deposited in the Legal Department's internal mail slot or mailed to the Company, marked confidential, to the attention of the Lead Director of the Corporate Governance and Nominating Committee. The unopened envelope will be forwarded to the Lead Director for review. The Lead Director of the Corporate Governance and Nominating Committee and Legal Department representative will conduct an investigation with the assistance of the Audit Committee and internal departments within the Company, as deemed appropriate. The complaint will be investigated according to established procedures for review. Where action is deemed warranted, action will be taken to resolve the situation which has been the source of the complaint.

Summary of Risks and Uncertainties

Before making an investment decision with respect to the Company's Common Shares, investors should carefully consider the following risk factors, in addition to the other information included or incorporated by reference into this report and the annual report for the fiscal year ended June 30, 2010. The risks as set out in the annual report remain unchanged.

The primary risks that may affect the Company during this fiscal year are summarized below. If any of the risks and uncertainties occurs, the business, financial condition, prospects, or results of operations for the Company would likely suffer.

If any of the following risks occur, the Company's business, results of operations or financial position could be materially adversely affected.

- The Company expects to continue to experience losses as a result of its ongoing research. It is difficult to estimate the timing and future costs of its research and development programs and the timing of the achievement of milestone revenues.
- The Company may be unable to achieve certain milestones associated with the external partnership, which could curtail future development and negatively impact the Company's share price.
- If the Company cannot raise additional capital on acceptable terms, it may delay or be unable to pursue further development of its product portfolio, obtain regulatory approvals or commercialize its product candidates.
- The Company is indirectly subject to price regulation in certain countries and this could affect its gross margin.
- The Company does not currently have backup manufacturing capacity for some of its key products.
- The loss of a key supplier of certain raw materials could have a material adverse effect on the Company's business and financial condition.
- The Company may not achieve its projected development goals in the timeframes it announces and expects.
- Rapid technological change could make the Company's products obsolete.
- The Company faces uncertainties related to regulatory approval which could result in delays in product commercialization in certain territories.
- Even if the Company obtains marketing approval, its products will be subject to ongoing regulatory review.
- The Company's products, if approved, may fail to achieve market acceptance.
- Development of therapeutics can be costly and require years of research and development activities.
- If the Company is unable to protect its intellectual property rights, its competitors may develop and market products with similar features that may reduce demand for its products and the effective commercialization of its products may be inhibited.
- The Company may become involved in lawsuits with respect to collaborations or protection or enforcement of its patents that would be expensive and time-consuming.
- If third-party manufacturers of the Company's products fail to devote sufficient time and resources to its concerns, or if their performance is substandard, clinical trials and product introductions may be delayed and costs may rise.
- The Company may not be able to manufacture its products in commercial quantities, which would prevent it from marketing its products.
- The Company may not be able to successfully achieve its goals.
- The Company has international operations that expose it to additional business risks.
- The Company may incur losses associated with foreign currency fluctuations.
- The Company is subject to the risk of product liability claims, for which it may not have, nor be able to obtain, adequate insurance coverage.
- Some of the Company's products involve may use hazardous materials and, as a result, it is exposed to potential liability claims and to costs associated with complying with laws regulating hazardous waste.
- Future sales of Common Shares by the Company or its existing lenders or shareholders may cause its share price to fall.
- The Company has never paid dividends on its Common Shares, and it does not anticipate paying any cash dividends in the foreseeable future.

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.



Brian D. Ford, CA,
Chief Financial Officer

The accompanying consolidated financial statements for **Bioniche Life Sciences Inc.** are management's responsibility and have been approved by the Bioniche Life Sciences Inc. Board of Directors. These financial statements were prepared in accordance with Canadian generally accepted accounting principles. They include some amounts that are based on estimates and judgments. The financial information contained elsewhere in the annual report is consistent with those obtained in the financial statements.

To ensure the accuracy and the objectivity of the information contained in the financial statements, the management of Bioniche Life Sciences Inc. maintains a system of internal accounting controls. Management believes that this system gives a reasonable degree of assurance that the financial documents are reliable and provide an adequate basis for the financial statements, and that the Company's assets are properly accounted for and safeguarded.

The Board of Directors upholds its responsibility for the financial statements in this annual report primarily through its Audit Committee. The Audit Committee is made up of independent directors who review the Company's annual consolidated financial statements, as well as Management's Discussion and Analysis of operating results and financial position, and recommend their approval by the Board of Directors. Ernst & Young LLP, Chartered Accountants, the external auditors designated by the shareholders, periodically meet with the Audit Committee to discuss auditing, the reporting of financial information and other related subjects.



Graeme McRae
Chairman of the Board,
President and Chief Executive Officer

Belleville, Canada
September 9, 2010



Brian D. Ford, CA,
Chief Financial Officer

To the Shareholders of

Bioniche Life Sciences Inc.

We have audited the consolidated balance sheets of **Bioniche Life Sciences Inc.** [the "Company"] as at June 30, 2010 and 2009 and the consolidated statements of shareholders' equity, loss and comprehensive loss, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Montréal, Canada
September 3, 2010

Ernst & Young s.r.l.
Chartered Accountants

Bioniche Life Sciences Inc.

Amalgamated under the laws of Ontario

CONSOLIDATED BALANCE SHEETS

[see going concern uncertainty — note 1]

As at June 30 (thousands of Canadian dollars)	2009 \$	2008 \$
ASSETS [notes 9 and 11[c]]		
Current		
Cash and cash equivalents	11,070	5,950
Accounts receivable [note 4[a]]	8,601	3,720
Income taxes receivable	63	—
Future income tax assets [note 17]	197	—
Inventories [note 5]	6,668	5,408
Prepaid expenses and deposits	793	569
Restricted cash [note 11[c]]	—	1,227
	27,392	16,874
Long-term		
Property, plant and equipment [note 6]	16,584	9,494
Intangible assets [note 7]	6,500	6,792
Goodwill	456	456
Long-term accounts receivable [note 4[b]]	1,156	1,025
Future income tax assets [note 17]	51	—
	52,139	34,641
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Revolving credit facility [note 8]	—	4,448
Accounts payable and accrued liabilities	9,716	11,607
Income and other taxes payable	—	321
Deferred government incentives [note 11]	—	342
Current portion of long-term debt and obligations under capital leases [notes 9 and 10]	256	635
Current portion of repayable government assistance [note 11[a][i]]	960	—
Current portion of non-refundable deferred licensing revenue [note 12]	1,486	—
	12,418	17,353
Long-term		
Long-term debt [note 9]	1,341	1,149
Obligations under capital leases [note 10]	1,184	1,225
Repayable government assistance [note 11]	6,965	2,476
Deferred government incentives [note 11]	2,382	3,335
Non-refundable deferred licensing revenue [note 12]	19,353	—
	43,643	25,538
Shareholders' equity		
Share capital [note 13]	96,677	95,855
Other paid-in capital [note 13]	8,700	8,539
Deficit	(96,881)	(95,291)
	8,496	9,103
	52,139	34,641

Commitments and contingencies [note 20]

Subsequent event [note 25]

See accompanying notes

On behalf of the Board:



Director



Director

Bioniche Life Sciences Inc.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

[see going concern uncertainty — note 1]

(thousands of Canadian dollars, except share amounts)	Common shares		Preferred shares — Series 1		Preferred shares — Series II		Special warrants	Other paid-in capital	Deficit	Total
	#	\$	#	\$	#	\$				
Balance, June 30, 2008	65,782,510	83,982	167	161	9,000,000	8,799	2,174	6,056	(84,791)	16,381
Net loss for the year	—	—	—	—	—	—	—	—	(10,500)	(10,500)
Issued under employee share ownership plan [note 13(c)(iii)]	1,171,916	593	—	—	—	—	—	—	—	593
Fair value of stock options vested [note 13(e)]	—	—	—	—	—	—	—	247	—	247
Directors' remuneration	161,672	113	—	—	—	—	—	—	—	113
Warrants issued in connection with the revolving credit facility	—	—	—	—	—	—	—	61	—	61
Revolving credit facility principal payments made in shares [note 13(c)(iii)]	4,565,049	1,967	—	—	—	—	—	—	—	1,967
Special warrants expired	—	—	—	—	—	—	(2,174)	2,174	—	—
Options issued to a consultant	—	—	—	—	—	—	—	1	—	1
Write-off of employee share purchase loan [note 13(c)(iv)]	—	240	—	—	—	—	—	—	—	240
Balance, June 30, 2009	71,681,147	86,895	167	161	9,000,000	8,799	—	8,539	(95,291)	9,103
Net loss for the year	—	—	—	—	—	—	—	—	(1,590)	(1,590)
Issued under employee share ownership plan [notes 13(c)(iii) and 19]	639,176	464	—	—	—	—	—	—	—	464
Fair value of stock options vested [note 13(e)]	—	—	—	—	—	—	—	240	—	240
Directors' remuneration	278,495	103	—	—	—	—	—	—	—	103
Warrants exercised	211,429	165	—	—	—	—	—	(61)	—	104
Options exercised	80,000	90	—	—	—	—	—	(18)	—	72
Balance, June 30, 2010	72,890,247	87,717	167	161	9,000,000	8,799	—	8,700	(96,881)	8,496

See accompanying notes

Bioniche Life Sciences Inc.

**CONSOLIDATED STATEMENTS OF LOSS
AND COMPREHENSIVE LOSS**

[see going concern uncertainty — note 1]

Years ended June 30 (thousands of Canadian dollars, except share and per share amounts)	2010 \$	2009 \$
REVENUES		
Sales	26,993	33,281
Licensing [note 12]	16,203	—
Research collaborations [note 12]	1,820	—
Gain on disposal of intangible assets [note 24]	883	—
	45,899	33,281
EXPENSES		
Cost of sales (excluding amortization) [note 5]	12,729	14,432
Administration	6,841	6,109
Marketing and selling [note 11[b]]	6,264	6,096
Other expenses [note 18]	—	863
Financial expenses [note 22]	726	2,465
Amortization of property, plant and equipment	1,080	1,343
Amortization and write-down of intangible assets	813	897
Foreign exchange loss (gain)	505	(191)
	28,958	32,014
Income before research and development expenses and other items	16,941	1,267
Research and development expenses, gross	17,922	13,315
Repayable government assistance [note 11[a][i]]	3,884	—
Less: government assistance, net [note 11]	(3,181)	(1,862)
Loss before income taxes	(1,684)	(10,186)
Provision for income tax (recovery) expense [note 17]	(94)	314
Net loss and comprehensive loss for the year	(1,590)	(10,500)
Basic and fully diluted net loss per share	(0.02)	(0.15)
Weighted-average number of common shares outstanding	72,239,959	70,313,509

See accompanying notes

Bioniche Life Sciences Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

[see going concern uncertainty — note 1]

Years ended June 30 (thousands of Canadian dollars)	2010 \$	2009 \$
OPERATING ACTIVITIES		
Net loss for the year	(1,590)	(10,500)
Add (deduct) non cash items:		
Amortization	1,841	2,140
Accreted interest on discounted receivables and interest-free loans and amortization of financial expenses	471	1,472
Write-off of intangible assets	52	100
Unrealized foreign exchange loss (gain)	(47)	244
Deemed government assistance	(81)	(284)
Stock-based compensation expense	240	487
Warrants issued to consultants	—	1
Repayable government assistance [note 11[a)][i]]	3,884	—
Licensing revenue [note 12]	(1,447)	—
Amortization of deferred government incentive	(1,689)	—
Future income taxes	(248)	—
Employee share ownership plan	528	533
Gain on sale of intangible assets	(883)	—
	1,031	(5,807)
Decrease (increase) in restricted cash	1,227	(1,227)
Net change in non-cash working capital balances [note 21]	(7,960)	4,068
Net change in non-refundable deferred licensing revenue [note 12]	22,286	—
Cash provided by (used in) operating activities	16,584	(2,966)
INVESTING ACTIVITIES		
Government incentives received on account of property, plant and equipment	1,098	80
Proceeds on sale of intangible assets	606	—
Proceeds on disposal of property, plant and equipment	21	—
Purchases of intangible assets	(521)	—
Purchases of property, plant and equipment	(7,789)	(1,405)
Cash used in investing activities	(6,585)	(1,325)
FINANCING ACTIVITIES		
Proceeds from government assistance	1,706	3,409
Payment of financing fees – debt	(2,117)	(11)
Proceeds from exercise of stock options	72	—
Proceeds from exercise of warrants	104	—
Proceeds from deferred government incentives	407	121
Proceeds from revolving credit facility	—	31,475
Repayment of revolving credit facility	(4,416)	(28,448)
Repayment of capital lease obligations	(292)	(298)
Repayment of long-term debt	(343)	(407)
Cash provided by (used in) financing activities	(4,879)	5,841
Net increase in cash and cash equivalents during the year	5,120	1,550
Cash and cash equivalents, beginning of year	5,950	4,400
Cash and cash equivalents, end of year	11,070	5,950

See accompanying notes

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

1. Nature of The Business and Going Concern Uncertainty

NATURE OF THE BUSINESS

Bioniche Life Sciences Inc. [the "Company"] is a Canadian biopharmaceutical company engaged in the research, development, manufacturing and commercialization of human and animal health products and technologies worldwide. The Company's common stock is traded on the Toronto Stock Exchange ["TSX" symbol "BNC"].

Headquartered in Belleville, Ontario, the Company has offices and manufacturing facilities in Canada, the United States, Europe and Australia.

The Company has three business units: **Human Health**, **Animal Health** and **Food Safety**.

- The **Human Health business unit** is responsible for research, discovery and clinical development of human health products. Its revenues are generated from sales of proprietary products, royalties and licensing arrangements.
- The **Animal Health business unit** is responsible for the research, development, manufacturing and marketing of animal health products worldwide. Established in 1979, Bioniche Animal Health develops technologies to replace antibiotics in livestock, among other activities. The Animal Health division has operations in Canada, the United States, Europe and Australia.
- The **Food Safety business unit** is responsible for research, development, manufacturing and marketing of biopharmaceutical animal health products to help prevent disease in humans and improve the safety of food and water supplies worldwide. The current leading initiative for the division is the development and commercialization of a cattle vaccination to help reduce the spread of the *E.coli* O157:H7 bacteria.

GOING CONCERN UNCERTAINTY

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ["GAAP"] on a going concern basis, which presumes the Company will continue in operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business for the foreseeable future. The use of these principles may not be appropriate. As of June 30, 2010, there was uncertainty that the Company will be able to continue as a going concern without obtaining additional financial resources.

The Company has incurred significant losses and has an accumulated deficit of \$96,881 as at June 30, 2010. The Company's committed cash obligations and expected level of expenditures for Fiscal 2011 exceed its committed sources of funds. To date, the Company has financed its cash requirements primarily through the issuance of shares, product sales, investment tax credits, the sale of businesses or business units, royalties, government assistance, long-term debt issuances and a revolving credit facility. In addition to traditional sources of cash, the Company expects to finance many of its future expenditures, by receiving certain payments on accomplishing milestones along with receiving reimbursements for certain costs associated with the conduct of the *Urocidin*TM clinical programs, from its licensing partner. If the Company is unable to accomplish the milestones on a timely basis, obtain a revolving credit facility or obtain sufficient additional equity financing, all of which are outside of management's control, the Company may be required to curtail the its development activities and operations.

These consolidated financial statements do not give effect to any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company not be successful in its efforts to obtain additional financing, or to receive significant funds on entering into research collaborations. Such adjustments could be material.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

2. Summary of Significant Accounting Policies

BASIS OF CONSOLIDATION

The consolidated financial statements reflect the consolidated financial position and results of operations of the Company and its active subsidiaries, Bioniche Animal Health Canada Inc., Bioniche Animal Health USA, Inc., Bioniche Animal Health (Europe) Ltd., Bioniche Animal Health (A/Asia) Pty. Ltd. and Bioniche (A/Asia) Pty. Ltd.

USE OF ESTIMATES

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include, but are not limited to, the measurement of allowance for doubtful accounts, impairment assessments, tax credits, as well as stock-based compensation, the valuation of inventory, the period over which non-refundable deferred revenue is recognized and the period over which intangible assets are amortized. The reported amounts and note disclosures 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 these consolidated financial statements and such differences may be material.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash and highly liquid short-term investments with maturities of less than three months from the date of acquisition that are readily convertible to known amounts of cash at any time and that are subject to an insignificant risk of change in value. Due to the liquid nature of these financial assets, the Company has elected to classify them as held for trading and changes in fair value are recorded in the consolidated statement of loss and comprehensive loss. As at June 30, 2010, cash equivalents amounted to \$6,761 [2009 – nil].

INVENTORIES

Inventories are valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis. Cost is comprised of direct materials, direct labour and an overhead allocation.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are carried at cost less any applicable government assistance and accumulated amortization.

Assets acquired under capital leases are carried at cost, being the present value of the minimum lease payments after the deduction of any executory costs.

Amortization of property, plant and equipment is calculated over their estimated useful lives using the following methods and rates:

Buildings	5% declining balance
Building under capital lease	straight-line basis over ten years
Equipment	20% declining balance
Equipment under capital lease	20% declining balance
Computer equipment	straight-line basis over five years
Automobiles	straight-line basis over five years
Automobiles under capital lease	straight-line basis over five years
Leasehold improvements	straight-line basis over the lease term

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

2. Summary of Significant Accounting Policies [Cont'd]

Construction in progress comprises construction and engineering costs. No amortization is recorded until construction is substantially complete and the assets are ready for productive use. Interest costs relating to funds borrowed for construction in progress are expensed as incurred.

INTANGIBLE ASSETS

Intangible assets represent technology costs, patents and trademarks and the costs to acquire licenses. Intangible assets also include software that is not an integral part of the related hardware or equipment.

Amortization of intangible assets are calculated over their estimated useful lives using the straight-line methods over the following periods:

Technology	over twenty years
Patents and trademarks	over the remaining life of the patent
License agreements	over a period of not more than five years
Distribution agreement	over ten years
Software	over five years

If a license agreement is terminated, the unamortized costs relating to the agreement are charged to income. All costs related to the development of patents and trademarks are expensed as incurred.

IMPAIRMENT OF LONG-LIVED ASSETS

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset to be held and used with the total of the undiscounted cash flows expected from its use and disposal. If such assets are considered impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the assets exceeds its fair value generally determined on a discounted cash flow basis. Any impairment results in a write-down of the asset and a charge to income during the year.

GOODWILL

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the tangible and intangible assets acquired, less liabilities assumed, based on their fair values. When the Company enters into a business combination, the purchase method of accounting is used. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit, including goodwill, is compared with its fair value. When the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the reporting unit exceeds its fair value, in which case the implied fair value of the goodwill, determined in the same manner as the value of goodwill is determined in a business combination, is compared with its carrying amount to measure the amount of the impairment loss, if any.

GOVERNMENT INCENTIVES

Government incentives with respect to property, plant and equipment are netted against the related asset cost when earned. Incentives related to research and development are deferred until the respective costs are incurred and all conditions related to the government incentives have been met, at which time they are recorded as a reduction of research and development expenses.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

2. Summary of Significant Accounting Policies [Cont'd]

REVENUE RECOGNITION

Product revenue is recognized when the product is shipped to the Company's customers, provided the Company has not retained any significant risks of ownership or future obligations with respect to the product shipped, prices are fixed or determinable, and collection is reasonably assured.

Interest income is accrued as it is earned.

Revenue arrangements from research and development collaborations, and licensing arrangements with multiple elements are reviewed in order to determine whether the multiple elements can be divided into separate units of accounting, if certain criteria are met. If separable, the consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

Licensing revenue — For up-front non-refundable licensing payments received by the Company, revenue is deferred and recognized on a straight-line basis during the term over which the Company maintains substantive contractual obligations. For any portion of an up-front licensing payment that is subject to a refund, the revenue is deferred. Once the refund condition lapses, revenue is recognized on a straight-line basis during the term over which the Company maintains substantive contractual obligations. Milestone payments are immediately recognized as licensing revenue when the underlying condition is met; the milestone is not a condition to future deliverables; and collectibility is reasonably assured. Amounts received in advance of recognition are included in deferred revenue.

Research collaborations — The Company recognizes revenue from research agreements as the contracted services are performed in accordance with the terms of the specific agreements.

RESEARCH AND DEVELOPMENT COSTS

Research costs, which include a share of administration expenses, are charged to income as incurred net of government incentives and tax credits earned. Development costs are charged against income in the year of the expenditure unless a development project meets the criteria under GAAP for capitalization and amortization. At June 30, 2010 and 2009, no development costs have been capitalized.

FOREIGN CURRENCY TRANSLATION

The Company's foreign subsidiaries are considered to be integrated foreign entities and are accounted for in accordance with the temporal method, as are transactions in foreign currencies entered into by the Company. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end exchange rate, non-monetary assets and liabilities are translated at the historical exchange rate, and revenue and expense items are translated into Canadian dollars at rates of exchange in effect at the related transaction dates. Exchange gains and losses arising from these transactions are included in income.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

2. Summary of Significant Accounting Policies [Cont'd]

INCOME TAXES

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future tax assets are recognized only to the extent that it is more likely than not that future tax assets will be realized. A valuation allowance is provided to the extent that tax assets are not expected to be realized.

EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is calculated using the weighted average number of Common Shares outstanding during the year. Diluted earnings (loss) per share is calculated using the treasury stock method, giving effect to the exercise of all dilutive factors. The treasury stock method assumes that any proceeds that could be obtained upon the exercise of options would be used to purchase Common Shares at the average market price during the year.

SHARE ISSUE COSTS

Share issue costs are recorded as a reduction of share capital.

FINANCING AND TRANSACTION COSTS

Financing costs associated with the issuance of debt are deferred, recorded as a reduction of the carrying value of the related debt and amortized over the term of the related debt using the effective interest method. Transaction costs, such as legal fees, that are directly attributable to the acquisition or issuance of financial assets or liabilities follow the same accounting treatment as financing costs.

STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

The Company has a stock-based compensation plan and has applied the fair value method of accounting. The fair value of stock options granted is determined at the measurement date using the Black-Scholes option pricing model and expensed over the vesting period of the options, with a corresponding increase to other paid-in capital. Any consideration paid on the exercise of stock options is credited to share capital.

3. Changes in Accounting Policies

The following Handbook Sections, released by the Canadian Institute of Chartered Accountants ["CICA"], were adopted by the Company on July 1, 2009. The impact of the adoption of these sections on the Company's consolidated financial statements is presented below.

Section 3064, *Goodwill and Intangible Assets*, which replaces Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*, establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Software that is not an integral part of the related hardware or equipment is now included in intangible assets rather than as part of property, plant and equipment. The adoption of this section had no impact on the Company's consolidated financial statements.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

3. Changes in Accounting Policies [Cont'd]

In May 2009, the CICA amended Section 3862, *Financial Instruments — Disclosure*, to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosure. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements for financial assets and financial liabilities that are carried at fair value. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant inputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to Section 3862 are effective for the Company's consolidated financial statements as at June 30, 2010. The new disclosures are included in note 15.

RECENT ACCOUNTING PRONOUNCEMENTS

The CICA issued Handbook Sections 1582, *Business Combinations*, which replaces Section 1581, *Business Combinations*; 1601, *Consolidations*; 1602, *Non-controlling Interests*; and 1625, *Comprehensive Revaluation of Assets and Liabilities*. These standards are effective for the Company's interim and annual financial statements beginning on July 1, 2011, with earlier application permitted. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

In conjunction with these changes, amendments were made to CICA Section 1625 and CICA Section 3251 to remove guidance no longer applicable and to make these standards consistent with the suite of business combinations standards.

In December 2009, the CICA issued EIC 175, *Multiple Deliverable Revenue Arrangements*; replacing EIC 142, *Revenue Arrangements with Multiple Deliverables*. This abstract was amended to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated; (2) require, in situations where a vendor does not have vendor-specific objective evidence or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance.

The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If the abstract is adopted early, in a reporting period that is not the first reporting period in the entity's fiscal year, it must be applied retroactively from the beginning of the Company's fiscal period of adoption.

The Company is currently assessing the future impact of these amendments on its consolidated financial statements and has not yet determined the timing and method of their adoption.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

4. Accounts Receivable and Long-term Accounts Receivable

[a] ACCOUNTS RECEIVABLE	2010	2009
	\$	\$
Trade	4,352	3,169
Government incentives receivable	2,700	308
Other	1,549	243
	8,601	3,720

[b] LONG-TERM ACCOUNTS RECEIVABLE		
Loans receivable	118	128
Government incentive holdbacks	1,146	1,085
	1,264	1,213
Less: Discount to reflect receivables at amortized cost	(108)	(188)
	1,156	1,025

Loans receivable includes \$100 at June 30, 2010 and 2009 outstanding from a former director. This amount is collateralized by shares in Bioniche Pharma Holdings Limited, a former subsidiary of the Company and earn-out payments to which the former director may be entitled. The loan is due on December 30, 2011. Loans receivable also includes \$18 at June 30, 2010 [2009 – \$28] outstanding from the chief executive officer and president who is also a director. The loan is payable in annual installments of \$5 per year. Both of these interest-free loans have been discounted at 12% and reflect their amortized cost.

Government incentive holdbacks of 10% are being applied on two government programs [note 11]. The Industrial Technology Office [“ITO”] holdback is being discounted at 7.5% and the Rural Economic Development Program [“RED”] holdback is being discounted at 5.69%. Both holdbacks are expected to be received in Fiscal 2012.

5. Inventories

	2010	2009
	\$	\$
Raw materials	1,714	1,002
Work-in-process	1,860	1,875
Finished goods	3,094	2,531
	6,668	5,408

During the year ended June 30, 2010, inventories in the amount of \$12,026 were recognized as cost of sales [2009 – \$13,731], including provisions for write-downs to net realizable value of \$308 [2009 – \$28], and a reversal of previously recorded write-downs of \$91 [2009 – \$45] primarily as a result of a change in estimate of unsalable inventory due to short dating, based on current estimates. As at June 30, 2010, inventories in the amount of \$31 are carried at their net realizable value [2009 – \$38].

*(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)***6. Property, Plant and Equipment**

	Cost \$	Accumulated amortization \$	Net book value \$
2010			
Land	1,266	—	1,266
Buildings	4,617	1,530	3,087
Building under capital lease	1,255	223	1,032
Equipment	7,149	5,542	1,607
Equipment under capital lease	364	103	261
Computer equipment	2,642	2,322	320
Automobiles	298	249	49
Automobiles under capital lease	995	348	647
Leasehold improvements	84	84	—
Construction in progress	8,315	—	8,315
	26,985	10,401	16,584
2009			
Land	1,266	—	1,266
Buildings	4,617	1,368	3,249
Building under capital lease	1,255	186	1,069
Equipment	7,080	5,447	1,633
Equipment under capital lease	230	59	171
Computer equipment	2,696	2,272	424
Automobiles	305	228	77
Automobiles under capital lease	677	180	497
Leasehold improvements	84	81	3
Construction in progress	1,105	—	1,105
	19,315	9,821	9,494

The Company leases a building from an officer and director of the Company. This building is included in building under capital lease and the corresponding capital lease obligation is included in obligations under capital leases [note 10]. The transaction was recorded at its exchange amount.

Amortization of assets under capital leases during the year ended June 30, 2010 amounted to \$249 [2009 – \$214].

At June 30, 2010, the Company had \$8,284 [2009 – \$1,105] in construction in progress relating to the scale up of a vaccine production facility in Belleville, Ontario and \$31 [2009 – nil] in construction in progress relating to the engineering design on the building under capital lease.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

7. Intangible Assets

	Cost \$	Accumulated amortization \$	Net carrying amount \$
2010			
Technology	11,974	6,295	5,679
Patents and trademarks	1,033	789	244
License agreements	565	401	164
Non-compete agreement	121	2	119
Software	294	—	294
	13,987	7,487	6,500
2009			
Technology	11,974	5,623	6,351
Patents and trademarks	1,033	724	309
License agreements	511	379	132
	13,518	6,726	6,792

During the year ended June 30, 2010, the Company purchased licenses and non-compete agreements for two animal health products totalling \$227 and wrote off a license valued at \$52 for an animal health product it will not be pursuing to market [2009 – \$100]. During the year ended June 30, 2010, the Company purchased \$294 in software [2009 – nil] related to a conversion in progress. This amount will not be amortized until full implementation of the project.

8. Revolving Credit Facility

On December 19, 2007, the Company's three-year revolving credit facility [the "Facility"] was amended to a maximum available amount of US\$5,500 from the previous maximum of US\$4,000. Amounts drawn are based on 90% of eligible accounts receivable and 35% of eligible North American inventory, capped at US\$2,500 plus an additional US\$3,000. A fee of US\$1,000 was charged by the lender for this amendment, payable in cash or in shares of the Company, at the discretion of the Company.

On October 31, 2008, the Facility was amended to extend the maturity date to March 2, 2009 and the interest rate became Wall Street Journal (WSJ) prime plus 2.5%, but not less than 10%. A fee of \$602 [US\$500] was charged by the lender for this amendment, payable in cash or in shares of the Company, at the discretion of the Company.

On March 2, 2009, the Facility became repayable on demand of the lender, and on April 27, 2009 the maturity date was again amended to June 30, 2009. A fee of \$503 [US\$400] was charged by the lender for this amendment, payable in cash. On June 22, 2009, the maturity date was again amended and the Facility again became repayable on demand.

All fees were recorded as a reduction in the carrying value of the Facility and were amortized over the remaining term of the Facility.

On September 9, 2008, the Company issued 4,565,049 Common Shares in lieu of cash principal repayments of the Facility, totalling \$1,967 [US\$1,850] and 211,429 five-year warrants valued at \$61 using the Black-Scholes option pricing model using the following assumptions: a risk-free interest rate of 5.5%, expected dividend yield of 0%, expected volatility of 66% and expected life of 5.0 years.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

8. Revolving Credit Facility [Cont'd]

The value of these warrants was recorded as a reduction of the carrying value of the Facility with a corresponding credit to other paid-in capital and was amortized over the remaining term of the Facility, which at that time ended December 9, 2008, using the effective interest method.

The Company had given a first charge over all of its North American assets except for certain intellectual property which is subject to a negative pledge pursuant to an agreement with the Government of Canada. On July 17, 2007, the lender released the mortgage that it had held on the manufacturing facility in Belleville, Ontario.

On July 20, 2009, the Company repaid the balance of the Facility as well as electing to pay all outstanding fees, totalling \$2,117 [US\$1,900], in cash.

9. Long-term Debt

	2010 \$	2009 \$
North American Operations		
[a] Business Development Bank of Canada	1,062	1,370
Australian Operations		
[b] ANZ Bank [2010 – A\$403; 2009 – A\$440]	359	409
Total senior debt	1,421	1,779
Less: unamortized financial expenses	—	64
Less: current portion	80	566
Total long-term debt	1,341	1,149

[a] On February 7, 2008, the Company entered into a ten-year, \$5,000 commercial loan facility with the Business Development Bank of Canada ["BDC"] repayable in monthly instalments of \$44. This loan facility is collateralized by certain property, plant and equipment at the Company's Belleville, Ontario facility and is subject to certain annual financial and non-financial covenants. The loan bears interest, payable monthly, at the BDC floating base rate [at June 30, 2009 – 4.25%] plus 2%, but the rate may be fixed at the Company's option at the then current BDC base rate.

On April 22, 2010, the terms and conditions of the loan were amended to postpone monthly payments for twelve months and establish a revised payment schedule to commence May 1, 2011 with one payment of \$20, twelve payments of \$25, thirteen payments of \$40 and fifty-six payments of \$62. The interest rate was increased to BDC floating base rate [June 30, 2010 – 4.5%] plus 2.5%.

At June 30, 2010, the effective interest rate on the amount borrowed to date was 7.00% [2009 – 8.94%]. Additional draw-downs on this loan facility will only be made if the Company makes certain qualifying expenditures. The proceeds must be used to finance the project to create an animal health and food safety vaccine manufacturing centre in Belleville, Ontario. Financing fees of \$87 were recorded as a reduction of the carrying value of the loan facility and were being amortized over the term of this loan facility using the effective interest rate method. The amendment of the repayment terms of the loan was considered to be an extinguishment of the loan, as such all unamortized financial expenses as at the date of the amendment in the amount of \$56 have been expensed in the year ended June 30, 2010.

At June 30, 2010, all covenants under this loan agreement have been met.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

9. Long-term Debt [Cont'd]

As at June 30, 2010, \$1,062 [2009 – \$1,370] has been drawn on this loan facility, \$45 current and \$1,017 long-term [2009 – \$528 current and \$842 long-term]. Commencing October 24, 2008, the Company began to pay a monthly standby fee equal to 1.5% per annum on the undrawn portion of the loan facility. At any time, the BDC may cancel the undrawn portion of the loan facility. The undrawn portion of the loan facility remained available to the Company, however the Company must provide a guaranteed irrevocable letter of credit to draw the last \$500 of the loan facility.

- [b] The Company entered into a A\$547 loan facility with ANZ Bank as of September 30, 2004 repayable over a 15-year term bearing interest at the bank's fluctuating mortgage index rate [2010 – 7.99%; 2009 – 6.44%] plus 1.03%. Principal and interest payments of \$5 [A\$6] [2009 – \$6; A\$6] are payable monthly. The Company has provided a first charge over real estate and certain property in Australia with a carrying value of \$596 [A\$681] [2009 – \$634; A\$698] as collateral for this loan.

Principal repayments on the Company's long-term debt for the next five years and thereafter are as follows:

	\$
2011	80
2012	353
2013	521
2014	267
2015	49
Thereafter	151
	1,421

10. Obligations Under Capital Leases

	2010 \$	2009 \$
Building, repayable in monthly instalments of \$17 until October 2015, including interest calculated at 10.1% [a]	1,067	1,267
Leases for equipment and automobiles, repayable in variable monthly instalments until July 2015, at interest rates ranging from 4.75% to 18.80%	825	678
	1,892	1,945
Less: interest included in minimum lease payments	338	401
Less: advances netted against building lease obligations	194	250
	1,360	1,294
Less: current portion	176	69
Total long-term obligations under capital leases	1,184	1,225

- [a] In May 2005, the Company entered into a capital lease with an officer and director of the Company to lease a building for a ten-year period. Minimum lease payments are \$17 per month. The Company had an agreement to reduce its monthly payments to the payment of interest only for the first two months of 2009. The obligation is calculated as the net present value of the future lease payments calculated at 10.1%. In addition, the Company received payments against non-interest bearing advances repayable on demand during the year ended June 30, 2010 related to the leased property in the amount of \$56 [2009 – advanced \$2] which have been offset against the obligations under this capital lease.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

10. Obligations Under Capital Leases [Cont'd]

Future annual minimum lease payments for the next five years and thereafter are as follows:

	\$
2011	495
2012	464
2013	406
2014	255
2015	205
Thereafter	67
	1,892

11. Deferred Government Incentives and Government Assistance

	2010			
	ITO	MEDT	Agri-Ops	Total
		\$	\$	\$
Opening balance	—	2,253	223	2,476
Government assistance repayable	4,800	—	—	4,800
Government assistance loans received	—	962	744	1,706
Less: interest-free discount	(916)	(210)	(419)	(1,545)
Accretion of interest	291	154	43	488
	4,175	3,159	591	7,925
Less: current portion	960	—	—	960
Total long-term repayable government assistance	3,215	3,159	591	6,965
Opening balance		283	59	342
Deemed government assistance netted against research and development expenses		(56)	(26)	(82)
Deemed government assistance netted against property, plant and equipment		(227)	(33)	(260)
Deferred government assistance — current portion		—	—	—

	2009		
	MEDT	Agri-Ops	Total
	\$	\$	\$
Government assistance loans received	2,932	477	3,409
Less: interest-free discount	(730)	(258)	(988)
Accretion of interest	51	4	55
Total long-term repayable government assistance	2,253	223	2,476
Government assistance related to interest-free discount	730	258	988
Government assistance netted against research and development expenses	(239)	(45)	(284)
Government assistance netted against property, plant and equipment	(208)	(154)	(362)
Deferred government assistance — current portion	283	59	342

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

11. Deferred Government Incentives and Government Assistance [Cont'd]

[A] INDUSTRIAL TECHNOLOGY OFFICE

Under the federal contribution program with Industry Canada's Industrial Technology Office ["ITO"], the Company is entitled to a reimbursement of 18.3% and 21.6% of the eligible operating and capital expenses incurred in the development and commercialization of *Urocidin* and the *E. coli* O157:H7 cattle vaccine to a maximum of \$9,600 and \$7,600, respectively. At the Company's discretion, it can claim reimbursements at accelerated rates of 35% for *Urocidin* and 28% for the *E. coli* O157:H7 cattle vaccine to the maximum as noted above. Under the agreements, if the Company does not reach certain expenditure levels for *Urocidin* and the *E. coli* O157:H7 cattle vaccine by September 30, 2011 and March 31, 2013, respectively, the portion of reimbursements received in excess of 18.3% and 21.6% of eligible expenditures become repayable to the ITO. In the event that either *Urocidin* or the *E. coli* O157:H7 cattle vaccine become commercially available prior to the required expenditure levels being reached, any amounts received under the accelerated claims are not repayable. These accelerated reimbursements are recorded as deferred government incentives. Once the maximum eligible reimbursement under each program has been received, claims for additional eligible expenditures will be applied against these deferred government incentive balances and the deferred balances will be recorded as government assistance.

At June 30, 2010, accelerated reimbursements of \$986 associated with the *Urocidin* project [2009 – \$2,675] and \$1,396 associated with the *E. coli* O157:H7 cattle vaccine project [2009 – \$660] are included in long-term liabilities for a total of \$2,382 [2009 – \$3,335]. The *Urocidin* project reached the maximum eligible reimbursement under the program during the year ended June 30, 2009. Claims for additional eligible expenditures are being applied against the deferred government incentive balance resulting in \$1,689 recorded as government assistance [2009 – \$311] of which \$3 has been netted against the related cost of property, plant and equipment [2009 – nil] and \$1,686 has been presented as a reduction in research and development expenses [2009 – \$311].

Total contributions claimed for the projects in fiscal 2010 were \$3,220 [2009 – \$679] of which \$736 was included in deferred government incentives [2009 – \$40] and \$2,191 [2009 – \$79] has been netted against the related cost of property, plant and equipment. The remaining amount of \$293 [2009 – \$560] has been presented as a reduction in research and development expenses.

[i] *Urocidin*

Under the current terms of the *Urocidin* agreement with ITO, the maturity date for the project was extended to September 30, 2011; royalties potentially payable to ITO, commencing upon regulatory approval for commercialization, are 6% of gross project revenues, to a cap of \$11,278, and annual cash payments of \$960 for five years, commencing with the occurrence of either regulatory approval for commercialization or by an agreement with a partner for either funding of the clinical development of the product or for the commercialization of the product, but no earlier than June 2010. The signing of a licensing agreement [note 12] for the development and marketing of *Urocidin* in the U.S. on July 10, 2009 triggered the requirement to make annual cash payments of \$960 for five years. The total amount of this obligation was recorded at its estimated fair value of \$3,884 using a discount rate of 7.5% as repayable government assistance with a corresponding expense of \$3,884. The discount is being amortized over the term of the loan using the effective interest method. The Company and the ITO are currently negotiating changes to the agreement which may result in significant changes to the nature and/or terms of the obligation.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

11. Deferred Government Incentives and Government Assistance [Cont'd]

ITO has exercised its option to withhold the last 10% of the funding for the *Urocidin* project until the project is completed, currently estimated to be September 30, 2011. As a result of the long-term nature of this asset, the Company has discounted the amount withheld of \$960 to its estimated fair value of \$875 [2009 – \$812] using a discount rate of 7.5% and classified it as a long-term accounts receivable [note 4[b]]. The discount was reflected as a reduction in government incentives and is being amortized over the term to expected receipt, using the effective interest method.

[ii] *E. coli* O157 Cattle Vaccine

Under the terms of the *E. coli* O157:H7 cattle vaccine agreement, the maturity date for the project was extended to March 31, 2013; royalties potentially payable to ITO related to gross project revenues, commencing no earlier than July 1, 2010 and no later than July 1, 2014 or the first day of the fiscal year where gross revenue exceeds \$500, increased to 2.5% from 1.49% with the cap on ITO's royalties increasing from \$6,763 to \$13,638, and the requirement to issue warrants to purchase Common Shares was removed.

[B] RURAL ECONOMIC DEVELOPMENT PROGRAM

On September 7, 2007, the Company announced an agreement for a government grant from the Rural Economic Development Program ["RED"] in the amount of \$2,000 based on eligible expenditures for market development related to its *E. coli* O157:H7 cattle vaccine. During fiscal 2009, the RED program agreed to accelerate funding from 50% of eligible expenditures to 70%, with the maximum total funding remaining unchanged. As at June 30, 2010, the Company has recognized \$1,862 [2009 – \$1,247] of this grant related to eligible expenditures incurred since August 16, 2007. As a result of a 10% holdback clause in this agreement, the Company has discounted its holdback receivable of \$186 [2009 – \$125] to its estimated fair value of \$184 [2009 – \$116] using a discount rate of 5.69% and classified it as a long-term accounts receivable [note 4[b]]. This discount will be amortized over the term that each claim amount is outstanding, using the effective interest method. The eligible amount less the discount has been netted against the related marketing expenses totaling \$613 [2009 – \$843].

[C] MINISTRY OF ECONOMIC DEVELOPMENT AND TRADE AND AGRI-OPPORTUNITIES PROGRAM

On December 18, 2007, the Company announced that it was eligible to receive up to \$10,000 in Ontario government financing in the form of a loan from the Ontario Ministry of Economic Development and Trade's 'Advanced Manufacturing Investment Strategy' program ["MEDT"] to fund eligible expenditures made by the Company since April 12, 2007, to scale up a vaccine production facility in Belleville, Ontario. During the incentive period, which runs until August 22, 2013, the loan is interest-free provided the Company meets certain targets by the end of the incentive period. To reflect the benefit of the interest-free period, the loan is discounted to its estimated fair value using a discount rate of 6.5% with the discount shown as a government grant. The discount will be amortized over the interest-free portion of the term of the loan, using the effective interest method. No principal payments are due during the incentive period. Interest at 5.69% begins to accrue on the first day following the incentive period. Beginning August 22, 2014 an annual payment of 20% of the principal balance plus accrued interest to that date becomes due. The loan is collateralized by a second charge on certain property, plant and equipment at the Company's Belleville, Ontario facility. At June 30, 2009, an advance received under this program to expedite the scale-up of the vaccine production facility was being held as restricted cash.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

11. Deferred Government Incentives and Government Assistance [Cont'd]

On December 20, 2007, the Company announced that it was eligible to receive up to \$5,000 in federal government financing in the form of a loan from the Department of Agriculture and Agri-Food (Canada) 'Agri-Opportunities' Program ["Agri-Ops"] to fund eligible expenditures made by the Company since September 21, 2007, and to scale-up the aforementioned vaccine production facility. The loan is interest free. To reflect the benefit of the interest-free status of the loan, the loan is discounted to its estimated fair value using a discount rate of 13.5% with the discount shown as a government grant. The discount will be amortized over the term of the loan using the effective interest method. Principal repayment begins July 1, 2013, with payments of \$83 per month. At June 30, 2009, an advance received under this program to expedite the scale-up of the vaccine production facility was being held as restricted cash.

As at June 30, 2010, no funds had been advanced under these two programs which were restricted in use for future eligible expenses associated with the vaccine manufacturing facility [2009 - \$1,227].

[D] NON-REFUNDABLE INVESTMENT TAX CREDITS

The Company has available non-refundable investment tax credits of \$8,448 as at June 30, 2010 related to research and development expenditures which may be utilized to reduce federal income taxes payable in future years and expire as follows:

	\$
2020	93
2021	301
2022	532
2023	594
2024	981
2025	1,000
2026	1,018
2027	1,031
2028	790
2029	914
2030	1,194
	8,448

The benefits of these non-refundable investment tax credits have not been recognized in the consolidated financial statements.

[E] SUMMARY OF GOVERNMENT ASSISTANCE

The government assistance recorded as a reduction of research and development expenses during the years ended June 30 is as follows:

	2010 \$	2009 \$
ITO	293	560
Less: discount to fair value on portion held back	—	(95)
MEDT interest-free discount	56	239
Agri-Ops interest-free discount	26	45
Amortization of deferred government incentives	1,686	311
Investment tax credits	1,120	802
	3,181	1,862

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

12. Non-refundable Deferred Licensing Revenue

On July 10, 2009, the Company signed a strategic partnership agreement [the "Agreement"] for the commercialization of *Urocidin*. Under the Agreement the Company received a non-refundable up-front cash payment of \$22,286 [US\$20,000]. This up-front payment has been recorded as deferred revenue and will be recognized over the period that the Company maintains substantive obligations under the Agreement, which the Company expects to be approximately 15 years. As at June 30, 2010, an amount of \$1,447 has been recognized as licensing revenue.

The Company also has the potential to receive a further US\$110 million in additional payments linked to the achievement of future clinical, regulatory and commercial milestones. During the year ended June 30, 2010, the Company achieved three milestones and recognized \$14,756 [US \$14,000] in licensing revenue.

The Company will also receive reimbursement, which will be negotiated between parties, of certain internal development costs and up to 100% of external development costs commencing in calendar 2010 if the Agreement is extended to consider markets outside of North America. On February 12, 2010, the Company announced that its partner, Endo Pharmaceuticals, has elected to exercise its option for global rights, thus assuming all external development expenses for the product. During the year ended June 30, 2010, the Company recognized \$1,820 in revenues for research collaboration services provided under the Agreement.

In addition to the above payments, the Company has retained exclusive product manufacturing rights and will receive a percentage of net sales related to the product.

13. Shareholders' Equity

SHARE CAPITAL

Authorized and Issued

The authorized capital of the Company is as follows:

- unlimited number of Common Shares; and
- unlimited number of Preferred Shares issuable in series with no par value

Share capital at June 30 consists of the following:

	2010 \$	2009 \$
[a] Preferred Shares – Series I	161	161
[b] Preferred Shares – Series II	8,799	8,799
[c] Common Shares	81,717	86,895
	96,677	95,855

[a] PREFERRED SHARES — SERIES I

The Series I shares are redeemable at the Company's option at \$1,000 each plus dividends, if any, which have been declared but not paid. The Series I shares are non-voting and are entitled to a fixed non-cumulative preferential dividend at the rate of 12% per annum. As at June 30, 2010 and 2009, no dividends have been declared or paid.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

13. Shareholders' Equity [Cont'd]

[b] PREFERRED SHARES — SERIES II

The Series II Preferred Shares are convertible at the option of the holder into Common Shares for five years plus one day at a conversion ratio which is obtained by dividing the fully accreted value by the applicable conversion price as follows: 25% at \$1.45; 50% at \$2.50; and 25% at \$3.75. The fully accreted value is calculated as the aggregate subscription price of the Preferred Shares plus 6% per annum until the earlier of conversion or five years from the date of issuance.

After the initial five-year plus one-day term, any Series II Preferred Shares outstanding are convertible, at the option of the holder, into Common Shares at the fully accreted value divided by the average market price of the Common Shares less the greater of 5% or the maximum discount permitted by the TSX [subject to the issuance of a maximum of 6,521,677 Common Shares in the aggregate on conversion of all Series II Preferred Shares].

If the trading price of the Common Shares exceeds \$13.50 for 60 consecutive days, the Company may require the holders to convert the Preferred Shares into Common Shares at the conversion ratio applicable on the date of conversion.

The Preferred Shares have voting rights on the basis of the number of Common Shares that the holder would have if the Preferred Shares were converted into Common Shares on the date of the applicable shareholders' meeting.

[c] COMMON SHARES

[i] Revolving debt principal payments made in shares

During the year ended June 30, 2009, the Company made Facility repayments of \$1,967 [US \$1,850] through the issuance of 4,565,049 Common Shares.

[ii] Share bonus

During the year ended June 30, 2009, the Company reversed a bonus it had accrued at June 30, 2008 which it expected to settle by issuing Common Shares of the Company's stock with a fair value of approximately \$504. No additional share bonus has been accrued at both June 30, 2010 and 2009.

[iii] Employee share ownership plan

The Company has an employee share ownership plan in Canada whereby the Company matches contributions made by employees for the purpose of purchasing the Company's stock. In April 2009, issued shares reached the maximum shares available under the plan, at which time the plan was suspended. The plan was reinstated in November 2009, following approval of a resolution to amend the plan by the Company's shareholders. The Company's portion of this plan is recorded as a stock-based compensation expense in the period incurred and totaled \$528 for the year ended June 30, 2010 [2009 – \$533]. At June 30, 2010, 69,307 Common Shares under this plan remain to be issued [2009 – nil] and an amount of \$64 [2009 – nil] has been recorded in current liabilities. In 2009, 86,600 outstanding Common Shares were issued and an amount of \$60 was recorded as Common Shares.

[iv] Employee share purchase loan

During 1995, the Company loaned \$240 to a former officer and current director to purchase 40,000 Common Shares, on a non-interest bearing basis with no set terms of repayment. During the year ended June 30, 2009, this loan was forgiven and the corresponding stock-based compensation expense has been included in administration expenses on the statement of loss and comprehensive loss with a corresponding increase to share capital.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

[d] WARRANTS

A summary of the Company's warrants outstanding as at June 30, 2010 is presented below:

Range of exercise prices	Warrants outstanding and exercisable		
	Number Outstanding #	Weighted average remaining contractual life [years] #	Weighted average exercise price \$
\$0.77 to \$1.10	1,420,000	0.97	1.02

The following table summarizes information about the warrants outstanding at June 30:

	2010		2009	
	Warrants #	Weighted average exercise price \$	Warrants #	Weighted average exercise price \$
Outstanding, beginning of year	1,711,429	0.96	10,903,861	1.37
Granted to revolving credit facility holder	—	—	211,429	0.49
Exercised	(211,429)	0.49	—	—
Expired	(80,000)	1.04	(9,403,861)	1.43
Outstanding, end of year	1,420,000	1.02	1,711,429	0.96

On March 13, 2009, all special warrants and compensation warrants issued under a unit offering completed in March 2007 were delisted, then extended as unlisted warrants to May 12, 2009. The value of this modification was not significant. They all subsequently expired. On May 11, 2010, the Company issued 211,429 Common Shares on the exercise of warrants for cash consideration of \$104. This amount plus \$61, which was removed from Other paid-in capital, was added to share capital.

[e] STOCK OPTION PLAN

On November 5, 2009, the Company's shareholders approved a resolution to amend the Company's stock option plan. This amendment changes the total number of Common Shares available to be issued under the plan from a maximum of 6,000,000 to a maximum of 10% of the Company's issued and outstanding Common Shares. As at June 30, 2010, the maximum number of Common Shares available to be issued under the plan cannot exceed 7,289,025. Under this plan, the Company has issued 4,686,146 [2009 – 3,336,501] Stock Options. In addition, outside of the Stock Option Plan ["Additional Options"], 4,000 Options were issued to a consultant and 780,000 Options were granted in Fiscal 2006 as an employment inducement, bringing total outstanding Options to 5,470,146 at June 30, 2010 [2009 – 4,118,501].

The exercise price of each Option equals no less than the market rate at the date immediately preceding the date of the grant. In general, Options issued under the plan vest and are exercisable in equal amounts over five years at the anniversary date of the grant. The Additional Options have the same terms as the Company's Stock Option Plan except that they will not be issued until target per share prices are attained, at which time the issued Options will vest in equal amounts over five years. The Additional Options have a ten-year contractual life.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

13. Shareholders' Equity [Cont'd]

During the year ended June 30, 2010, the Company issued 2,000 three-year fully vested Options [2009 – 2,000 three-year fully vested Options] with an exercise price of \$0.37 [2009 - \$0.70] to a consultant as previously approved at the November 8, 2007 Annual Shareholders' Meeting.

On November 5, 2009, the Company granted 2,671,867 [2009 – nil] five-year Options with an exercise price of \$0.44 to employees and directors. In Fiscal 2009, the Company elected to modify Options previously granted to a member of the Board of Directors, now deceased. The value of this modification of \$5 was recorded as an administration expense, with an offset to other paid-in capital.

A summary of the status of the Company's Stock Option Plan as at June 30, 2010 is presented below:

Range of exercise price	Options outstanding			Options exercisable	
	Number outstanding #	Weighted average remaining contractual life [years] #	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
\$0.37 to \$0.44	2,601,145	4.5	0.44	2,000	0.37
\$0.70 to \$0.93	1,700,000	1.4	0.89	1,179,000	0.89
\$1.10 to \$1.60	260,000	1.3	1.49	166,000	1.46
\$1.68 to \$2.40	400,000	6.0	2.20	—	—
	509,001	5.1	3.03	109,001	3.15
	5,470,146	3.5	1.00	1,456,001	1.12

The following table summarizes information about Stock Options outstanding at June 30:

	2010		2009	
	Options \$	Weighted average exercise price \$	Options \$	Weighted average exercise price \$
Outstanding, beginning of year	4,118,501	2.04	4,286,501	2.06
Granted	2,673,867	0.44	2,000	0.70
Expired	(1,242,222)	3.30	(170,000)	2.06
Exercised	(80,000)	0.90	—	—
Outstanding, end of year	5,470,146	1.00	4,118,501	2.04

Stock-based compensation is recorded as a compensation expense related to the expense category for the service provided by the optionee.

On March 15, 2010, the Company issued 80,000 Shares on the exercise of employee Stock Options for cash consideration of \$72. This amount, plus the previously expensed fair value of these Options of \$18 which was removed from Other paid-in capital, was added to share capital.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

13. Shareholders' Equity [Cont'd]

The fair value of options granted during the years ended June 30 was estimated at the grant date using the Black-Scholes option pricing model, resulting in the following weighted average assumptions:

	2010	2009
Risk-free interest rate	4.00%	5.50%
Expected volatility	65.1%	81.9%
Expected option life	5.0 years	3.0 years
Dividend yield	0%	0%
Weighted average fair value of options granted	\$0.24	\$0.35

14. Management of Capital

The Company's capital management objectives are to safeguard its ability to continue as a going concern and to fund its research and development activities, to pursue its commercialization efforts and to maintain its ongoing operations. To secure the additional capital necessary to pursue these plans, the Company may attempt to raise additional funds through the issuance of debt or equity, and by entering into strategic partnerships which will generate funds to finance its operations.

In the management of capital, the Company includes shareholders' equity, the Business Development Bank of Canada ["BDC"] loan facility and ANZ Bank mortgage included in long-term debt, and government assistance in the form of interest free loans from the Ministry of Economic Development and Trade, the Department of Agriculture and Agri-Food (Canada) and the Industrial Technology Office as well as non-refundable deferred licensing revenue.

All future advances on the BDC loan facility, the two government assistance loans and advances from the Industrial Technology Office are capital resources targeted for the scale-up of the vaccine production facility in Belleville, Ontario.

	2010	2009
	\$	\$
Revolving credit facility	—	4,448
Shareholders' equity	8,496	9,103
Long-term debt (including current portion)	1,421	1,715
Repayable government assistance (including current portion)	7,925	2,476
Non-refundable deferred licensing revenue (including current portion)	20,839	—
	38,681	17,742

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

15. Financial Instruments

CLASSIFICATION OF FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost. As at June 30, the classification of the financial instruments, as well as their carrying values and fair values, are shown in the tables below:

2010	Held for trading	Loans and receivables	Other financial liabilities	Total carrying value	Fair value
	\$	\$	\$	\$	\$
Financial assets					
Cash and cash equivalents	11,070	—	—	11,070	11,070
Accounts receivable ¹	—	7,240	—	7,240	7,240
Long-term accounts receivable	—	1,156	—	1,156	1,156
	11,070	8,396	—	19,466	19,466
Financial liabilities					
Accounts payable and accrued liabilities ²	—	—	9,505	9,505	9,505
Long-term debt	—	—	1,421	1,421	1,421
Government assistance loans	—	—	7,925	7,925	7,925
	—	—	18,851	18,851	18,851
2009					
	Held for trading	Loans and receivables	Other financial liabilities	Total carrying value	Fair value
	\$	\$	\$	\$	\$
Financial assets					
Cash and cash equivalents	5,950	—	—	5,950	5,950
Restricted cash	1,227	—	—	1,227	1,227
Accounts receivable ¹	—	3,539	—	3,539	3,539
Long-term accounts receivable	—	1,025	—	1,025	1,025
	7,177	4,564	—	11,741	11,741
Financial liabilities					
Revolving credit facility ²	—	—	4,448	4,448	4,448
Accounts payable and accrued liabilities ²	—	—	9,527	9,527	9,527
Long-term debt ³	—	—	1,779	1,779	1,779
Government assistance loans	—	—	2,476	2,476	2,476
	—	—	18,230	18,230	18,230

¹ Excluding non-financial assets comprised of provincial and federal sales taxes and tax credits receivable totaling \$1,361 [2009 – \$181].

² Excluding non-financial liabilities comprised of provincial and federal sales and capital taxes, accruals that are not contractual obligations and amounts that will be settled in shares totaling \$211 [2009 – \$2,080].

³ Excluding financing expenses recorded as a reduction of the loan balance totaling \$64 in 2009.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

15. Financial Instruments [Cont'd]

FAIR VALUE HIERARCHY

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs in making the measurements. The fair value hierarchy has the following levels:

Level 1 — valuation based on quoted prices observed in active markets for identical assets or liabilities.

Level 2 — valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 — valuation techniques with significant unobservable market inputs.

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The financial instruments recorded at fair value on the consolidated balance sheet are the cash and cash equivalents, classified as level 1.

FAIR VALUES

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. Accordingly, the estimated fair values are not necessarily indicative of the amounts the Company could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of financial instruments are described below:

- Given their short-term maturity, the fair value of accounts receivable, the revolving credit facility and accounts payable and accrued liabilities approximate their carrying values.
- Long-term accounts receivable are carried at amortized cost. As each component has been discounted at a rate the Company would expect for similar receivables, the amortized cost approximates fair value.
- The fair value of long-term debt is approximately equal to the carrying value due to the variable rates of interest charged on these loans.
- Government assistance loans are carried at their amortized cost, which approximates fair value due to the use of discount rates the Company would expect for similar loans.

FOREIGN CURRENCY RISK

The Company operates internationally and a substantial portion of its revenue from product sales is denominated in US dollars, Euros, New Zealand dollars and Australian dollars. This results in financial risk due to fluctuations in the value of the Canadian dollar relative to these currencies. The Company has a natural hedge for a portion of this risk, in that many of its expenditures are in US dollars, Euros and Australian dollars. Fluctuations in payments made for the Company's products could cause unanticipated fluctuations in the Company's consolidated operating results. At June 30, 2010 and 2009, the Company has not entered into any currency hedging contracts to manage foreign currency risk.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

15. Financial Instruments [Cont'd]

The significant balances in foreign currencies at June 30 are as follows:

	U.S. dollars		Euros	
	2010 \$	2009 \$	2010 €	2009 €
Cash and cash equivalents	1,166	3,051	196	228
Accounts receivable	3,462	1,676	320	462
Revolving credit facility	—	(3,868)	—	—
Accounts payable and accrued liabilities	(1,419)	(3,812)	(300)	(231)
	3,209	(2,953)	216	459

	AUS dollars		NZL dollars	
	2010 \$	2009 \$	2010 \$	2009 \$
Cash and cash equivalents	397	486	—	—
Accounts receivable	1,024	318	103	23
Accounts payable and accrued liabilities	(602)	(508)	(69)	(121)
Long-term debt	(403)	(462)	—	—
	416	(166)	34	(98)

Based on the above net exposure as at June 30, 2010 and 2009, and assuming that all other variables remain constant, a 10% appreciation or depreciation of the Canadian dollar against the other currencies would have resulted in the following impact on net loss and comprehensive loss:

2010	Canadian Dollar	
	Appreciate 10%	Depreciate 10%
	\$	\$
Against the US dollar	341	(341)
Against the Euro	29	(29)
Against the AUS dollar	37	(37)
Against the NZL dollar	2	(2)
Decrease (increase)	409	(409)

2009	Canadian Dollar	
	Appreciate 10%	Depreciate 10%
	\$	\$
Against the US dollar	341	(341)
Against the Euro	(75)	75
Against the AUS dollar	16	(16)
Against the NZL dollar	7	(7)
Decrease (increase)	289	(289)

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

15. Financial Instruments [Cont'd]

CREDIT RISK

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations.

The Company monitors the credit risk and credit standing of counterparties on a regular basis. Concentrations of credit risk with respect to trade accounts receivable are limited due to the large number of customers and their dispersion across many geographic areas.

	2010 \$	2009 \$
Current and not impaired	3,388	1,886
Past due in the following periods		
31 to 60 days	420	736
61 to 90 days	332	414
Over 90 days	228	141
Allowance for doubtful accounts	(16)	(8)
Trade accounts receivable	4,352	3,169

As at June 30, 2010, accounts receivable with respect to government incentives represented 10% of current assets [2009 – 2%].

At June 30, 2010, two customers comprised 22% of trade receivables [2009 – two customers, 25%].

Cash is held with one Canadian chartered bank, two U.S. banks, one Irish bank and one Australian bank.

The maximum extent of the Company's exposure to credit risk is the aggregate carrying value of the Company's financial assets.

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's objective is to provide for expected cash requirements and accommodate for changes in liquidity needs. The Company manages this risk by managing its capital structure, through continuous monitoring of its actual and projected cash flows.

The following are the undiscounted contractual maturities of financial liabilities at June 30:

2010	Total \$	1 year \$	2-3 years \$	4-5 years \$	More than 5 years \$
Revolving credit facility	—	—	—	—	—
Accounts payable and accrued liabilities	9,505	9,505	—	—	—
Long-term debt	1,718	183	1,014	352	169
Government assistance loans	10,580	960	1,920	4,142	3,558
	21,803	10,648	2,934	4,494	3,727

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

15. Financial Instruments [Cont'd]

2009	Total	1 year	2-3 years	4-5 years	More than
	\$	\$	\$	\$	5 years
					\$
Revolving credit facility	4,448	4,448	—	—	—
Accounts payable and accrued liabilities	9,527	9,527	—	—	—
Long-term debt	2,026	663	1,016	134	213
Government assistance loans	3,910	—	—	477	3,433
	19,911	14,638	1,016	611	3,646

INTEREST RATE RISK

Financial instruments that potentially subject the Company to cash flow interest rate risk are those assets and liabilities with a variable interest rate. Accounts receivable and accounts payable and accrued liabilities bear no interest. The revolving credit facility and both the BDC and ANZ bank loan facilities which are included in long-term debt have variable interest rates. Based on the carrying value of these variable interest-bearing liabilities as of June 30, 2010, an assumed 25 basis point ["pts."] increase or decrease in interest rates during the year ended June 30, 2010 would have resulted in an increase (decrease) in net loss and comprehensive loss as follows:

	Interest rate	
	Increase 25 pts. \$	Decrease 25 pts. \$
Decrease (increase) in net loss and comprehensive loss	(4)	4

Financial assets and financial liabilities that bear interest at fixed rates are subject to fair value interest rate risk. Certain cash equivalents bear interest at a fixed rate but are not deemed significant due to the short term of the investment. Long-term accounts receivable bear no interest but are carried at amortized cost, calculated using discount rates appropriate to each component. The Company's obligations under capital leases are at fixed rates of interest. The Company's government assistance loans are interest-free as described in note 11[c]. They are carried at amortized cost, calculated using discount rates appropriate to each component.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

16. SEGMENTED FINANCIAL INFORMATION

The Company's three reportable segments, Animal Health, Human Health and Food Safety are strategic business units that offer different products and require different technology and marketing strategies.

	2010				
	Human Health \$	Animal Health \$	Food Safety \$	Corporate \$	Total \$
Sales	—	26,993	—	—	26,993
Gain on disposal of intangible assets	—	883	—	—	883
Licensing and research collaborations	18,023	—	—	—	18,023
	18,023	27,876	—	—	45,899
Expenses	—	19,257	1,862	4,715	25,834
EBITDA before research and development	18,023	8,619	(1,862)	(4,715)	20,065
Research and development expenses	13,230	3,079	1,613	—	17,922
Repayable government assistance	3,884	—	—	—	3,884
Less: government assistance, net	(2,793)	(13)	(375)	—	(3,181)
Net research and development expenses	14,321	3,066	1,238	—	18,625
Interest expense, net	—	44	—	618	662
Amortization and write-down of property, plant and equipment and intangible assets	988	635	65	205	1,893
Financial expenses	—	—	—	64	64
Foreign exchange loss	—	—	—	505	505
Segment income (loss) before income taxes	2,714	4,874	(3,165)	(6,107)	(1,684)
Provision for income taxes					
– current	—	154	—	—	154
– future	—	(248)	—	—	(248)
Segment assets	11,271	17,130	10,809	12,929	52,139
Goodwill	—	456	—	—	456
Purchases of property, plant and equipment	254	331	7,107	453	8,145

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

16. Segmented Financial Information [Cont'd]

	2009				
	Human Health \$	Animal Health \$	Food Safety \$	Corporate \$	Total \$
Sales	—	33,276	5	—	33,281
Expenses	—	21,062	1,471	4,968	27,501
EBITDA before research and development	—	12,214	(1,466)	(4,968)	5,780
Research and development expenses	9,928	1,774	1,613	—	13,315
Less: government assistance, net	(1,517)	—	(345)	—	(1,862)
Net research and development expenses	8,411	1,774	1,268	—	11,453
Interest expense, net	—	47	—	630	677
Amortization of property, plant and equipment and intangible assets	1,173	839	50	178	2,240
Financial expenses	—	—	—	1,787	1,787
Foreign exchange gain	—	—	—	(191)	(191)
Segment income (loss) before income taxes	(9,584)	9,554	(2,784)	(7,372)	(10,186)
Provision for income taxes	—	314	—	—	314
Segment assets	9,558	14,226	2,364	8,493	34,641
Goodwill	—	456	—	—	456
Purchases of property, plant and equipment	82	126	1,139	134	1,481

The Company uses EBITDA [earnings before interest, taxes, depreciation and amortization] before research and development as a measure of each segment's contribution to the Company on an operational basis.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

16. Segmented Financial Information [Cont'd]

Segmented financial information analyzes the operations of the Company by the following geographic locations, based on the location of its customers:

	2010 \$	2009 \$
Revenue		
Canada	5,591	6,512
Europe*	1,052	1,277
United States	32,647	18,307
Australia	3,642	3,675
Other**	2,967	3,510
Total revenue	45,899	33,281

* Europe primarily includes Spain, the Netherlands, Ireland and the United Kingdom.

** Other primarily includes countries in Asia, South America and the Middle East.

	2010 \$	2009 \$
Total assets		
Canada	43,789	27,485
Ireland	744	1,337
United States	4,212	3,060
Australia	3,394	2,759
Total assets	52,139	34,641
Property, plant and equipment and goodwill		
Canada	16,133	8,988
Other	907	962
Total property, plant and equipment and goodwill	17,040	9,950

17. Income Taxes

The reconciliation of income tax computed at the statutory tax rates to the provision for income taxes is as follows:

	2010 \$	2009 \$
Loss before income taxes	(1,684)	(10,186)
Basic income tax rate	31.88%	32.87%
Computed income tax recovery (expenses)	537	3,348
Effect on income tax rate resulting from:		
Foreign jurisdictions rate differential	(10)	8
Unrecorded potential tax benefits of current period losses and other tax assets	(6,218)	(3,537)
Benefit of losses and other tax assets not previously recognized	3,493	212
Non-taxable accounting income	2,569	—
Accounting charges not deductible for tax purposes	(277)	(345)
	94	(314)

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

17. Income Taxes [Cont'd]

In the year ended June 30, 2010, the Company used \$10,752 of previously unrecognized losses to reduce its taxable income for Canadian federal and provincial purposes. The Company also recognized a future tax asset of \$248 related to timing differences in its US subsidiary as it was considered that it is more likely than not that there will be sufficient future taxable income to utilize these assets.

As at June 30, 2010, the Company has non-capital losses of approximately \$26,207 for Canadian federal and Ontario purposes and \$20,495 for Québec purposes that are available to offset future taxable income. These losses expire as follows:

	Federal and Ontario \$	Québec \$
2015	2,320	1,510
2026	3,767	2,046
2027	7,204	6,481
2028	7,283	5,766
2029	4,609	4,692
2030	1,024	—
	26,207	20,495

The Company has the following non-capital losses available for carryforward in foreign jurisdictions:

	\$	Expiry
Ireland	2,516	Unlimited
Australia	5,716	Unlimited

The Company has Scientific Research and Experimental Development ["SRED"] expenditures of approximately \$44,900 [2009 – \$39,000] for federal and Ontario income tax purposes and \$56,500 [2009 – \$49,000] for Québec income tax purposes, which have not been deducted. These expenditures are available to reduce future taxable income and have an unlimited carryforward period. Research and development tax credits and expenditures are subject to verification by the tax authorities and, accordingly, these amounts may vary.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

17. Income Taxes [Cont'd]

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax assets and liabilities are as follows:

	2010 \$	2009 \$
Future tax assets		
Net operating loss carryforwards	8,639	10,296
Tax basis of property, plant and equipment and intangible assets in excess of carrying values	2,254	2,341
Research and development expenditures	11,629	11,331
Deferred government assistance	1,336	849
Deferred licensing revenue	2,693	—
Other	247	60
Financing fees	122	807
Total gross future tax assets	26,920	25,684
Less: valuation allowance	(25,233)	(23,919)
Net future tax assets	1,687	1,765
Future tax liabilities		
Carrying value of intangible assets in excess of tax basis	1,439	1,765
Total future tax liabilities	1,439	1,765
Net future tax liabilities	248	—

The income tax benefits relating to the future tax assets have been recognized to the extent of the future tax liabilities under the liability method of tax allocation.

Significant components of the provision for recovery of income taxes are as follows:

	2010 \$	2009 \$
Current tax expense	3,399	526
Future income tax benefit resulting from recognition of loss carryforwards and other temporary differences	(3,493)	(212)
	(94)	314

18. Other Expenses

As a result of the Company's financial condition during the year ended June 30, 2009, a number of strategic initiatives were undertaken prior to the signing of the collaboration agreement described in note 12 and none of these initiatives were concluded. Costs incurred of \$863 consist primarily of professional fees.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

19. Employee Benefit Plans

The Company has two defined contribution pension plans for its US and Canadian employees. Contributions to these plans are expensed as incurred. The Company funded and charged to expense during the year ended June 30, 2010, for the defined contribution plans, an amount of \$745 of which \$464 was paid in shares. An additional \$64 was accrued at June 30, 2010 and paid in shares in July 2010 [2009 – \$587 of which \$533 was paid in shares] [note 13[c][iii]].

20. Commitments and Contingencies

[i] COMMITMENTS

The Company is committed under various operating leases for buildings and equipment to total future minimum lease payments as follows:

	\$
2011	292
2012	61
2013	26
2014	7
2015	7
	393

In addition to the royalties described in note 11[a], the Company is committed to paying royalties ranging from 1% – 5% as a result of certain license agreements on the sales of certain products on the commercialization of specific technologies or products.

At June 30, 2010, the Company had capital commitments with respect to plant and machinery under construction in relation to the vaccine manufacturing facility in the amount of \$15,000 [2009 – nil]. A portion of these commitments will be financed through government incentives and assistance and through loans with the Business Development Bank of Canada for a combined amount of approximately \$10,000.

On July 2, 2004, the Company initiated the funding of two Industrial Research Chairs at the Vaccine & Infectious Disease Organization, jointly with Natural Science and Engineering Research Canada. Under this agreement, the Company receives the first commercial rights to new food safety vaccines to fight infectious diseases of animals, including *Salmonella enteritidis*, *Campylobacter* and *Cryptosporidium parvum*. The Company's financial commitment is up to \$400 per year, payable semi-annually over five years. The final payment for this agreement of \$376 was expensed to research and development by the Company during the year ended June 30, 2009.

[ii] CONTINGENCIES

The Company is involved from time to time in litigation, which arises in the normal course of business. In respect of these claims the Company believes it has valid defenses and/or has made adequate provision for such claims. The Company believes that no material exposure exists on the eventual settlement of such litigation.

In December 2009, a former financial advisor, who had previously requested payment of 6% of the funds received under the Agreement [note 12], filed a lawsuit against the Company in relation to this request for payment. Management believes that this demand is frivolous and without merit and is contesting this claim vigorously, however the outcome is uncertain at this time. No amount has been recorded in the consolidated financial statements for this claim.

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

20. Commitments and Contingencies [Cont'd]

The Company participates in research and development funding arrangements, some of which, based on management's best estimates, are recorded as a reduction in the related cost and some as a deferred government incentives obligation. The funding arrangements are subject to audit by the contributors. Any adjustments which could be material will be made in the period in which they are known.

The Company periodically enters into research agreements with third parties that include indemnification provisions that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is unlimited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

Under an employment agreement, the Company is committed to pay royalties on net sales of MCC formulation which includes *Urocidin* at a rate 1.5% for the first \$10,000 of net sales and 1% for the next \$20,000 of net sales.

21. Consolidated Statements of Cash Flows

	2010	2009
	\$	\$
Net change in non-cash working capital balances:		
Accounts receivable	(3,405)	2,155
Inventories	(1,260)	(708)
Prepaid expenses and deposits	(223)	70
Accounts payable and accrued liabilities	(2,688)	2,335
Income and other taxes payable	(384)	216
	(7,960)	4,068

Included in accounts payable and accrued liabilities are liabilities in the amount of \$64 which the Company has the option to settle through the issuance of shares [2009 – \$1,837].

Supplemental cash flow information:

	2009	2008
	\$	\$
Cash paid for		
Income taxes	312	109
Interest	287	651
	599	760
Non-cash investing and financing activities		
Capital leases	356	156
Purchases of property, plant and equipment in accounts payable and accrued liabilities	3,127	—

(thousands of Canadian dollars or other currencies, except where noted and for share and per share amounts)

22. Financial Expenses

	2010	2009
	\$	\$
Interest on long-term debt	285	324
Other interest expense	27	417
Interest income	(56)	(59)
Accreted interest income on discounted receivables	(82)	(59)
Accreted interest expense on interest-free loans	488	55
Amortization of financial expenses	64	1,787
	726	2,465

23. Related Party Transactions

In addition to related party transactions disclosed elsewhere in the consolidated financial statements, the Company paid two directors \$82 [2009 – one director \$70] in consulting fees and purchased inventory items from a company owned by a director in the amount of \$15 [2009 – \$5]. The Company received payment for services provided to a company owned by a director of \$88 [2009 – \$45].

24. Gain On Disposal Of Intangible Assets

On July 23, 2009, the Company sold its interest in a regulatory registration in the United States for a veterinary anesthetic product, *Ketamine*, to Bioniche Teoranta, an unrelated company, for consideration of \$883 [US\$800]. The Company received \$606 [US\$549] in cash at closing and accounts payable of \$277 [US\$251] were forgiven.

The Company's interest in the regulatory registration represented an unrecorded internally developed intangible asset and as such, an amount of \$883, representing the entire consideration received, has been recorded as a gain on disposal of intangible assets.

25. Subsequent Event

On July 8, 2010, the Company became eligible to receive up to \$750 in the form of an interest free loan from the Federal Economic Development Agency for Southern Ontario to fund eligible expenses made by the Company between April 1, 2010 and March 31, 2011 to support the development of a pilot-scale fermentation facility. This facility is part of the Company's Animal Health and Food Safety Vaccine Manufacturing Centre, currently under construction. The loan is repayable in equal monthly instalments beginning on July 1, 2011 over a period of five years. Funding related to eligible expenditures amounting to \$40 has not been recognized, pending formalization of claims.

26. Comparative Consolidated Financial Statements

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2010 consolidated financial statements.

BOARD OF DIRECTORS**GRAEME McRAE** ^{(3) (4) (5) (6)}Chairman, President and CEO
Bioniche Life Sciences Inc.**STANLEY ALKEMADE, D.V.M.** ^{(4) (5) (6)}

President, BioMedEx Inc.

ARMEN APRIKIAN, M.D., F.R.C.S.**(C) (OBSERVER)** ⁽⁴⁾

Head, Division of Urology, Department of Surgery, McGill University & Interim Chief, Department of Oncology, McGill University Health Centre

ALBERT BERALDO ^{(1) (2) (6)}

President, Alveda Pharmaceuticals Inc.

MARGARET CUNNINGHAM, PH.D. ^{(1) (3) (6)}

Director of the School of Business, Associate Dean, and R. A. Jodrey Chair, Faculty of Management, Dalhousie University, Halifax, Nova Scotia

PIERRE-YVES DESBIENS, C.A., MBA ^{(1) (2) (6)}

Vice-President, Finance, PureCell Technologies Inc.

JAMES JOHNSON PH.D. ^{(4) (6)}

Principal and Founder, Johnson & Associates

NICK PHTIADIS ^{(1) (6)}

Management and Strategic Planning Consultant

LYLE VANCLIEF ^{(3) (6)}

Agricultural and Agri-Food Consultant

¹ Member of the Audit Committee² Member of the Compensation Committee³ Member of the Corporate Governance and Nominating Committee⁴ Member of the Scientific Audit Committee⁵ Member of the Risk Management Committee⁶ Each Director has been elected to hold office until the date of the Company's next Annual Meeting of Shareholders**EXECUTIVE MANAGEMENT****Graeme McRae**

Chairman, President and CEO

Cindy Benning

Vice-President, Operations, Corporate Quality and Regulatory Affairs

Monique Champagne

Vice-President, Clinical Research

François Charette, M.D., MBA

Senior Vice-President and Chief Medical Officer

Rick Culbert

President, Bioniche Food Safety

Mohamed Elrafih

Vice-President, Manufacturing Operations

Brian Ford, BA, CA

Vice-President, Finance and Chief Financial Officer

Andrew Grant

Divisional President, Bioniche Animal Health Export Sales, Europe & Australia

Cameron Groome

Executive Vice-President, Corporate & Strategic Development

Bruce McLeod

Vice-President, Human Resources

Jim Phillips

President, Bioniche Animal Health (Global)

Nigel C. Phillips, Ph.D.

Senior Vice-President, Scientific Affairs and Chief Scientific Officer

Dragan Rogan, Ph.D.

Vice-President, Research & Development Animal Health

Jennifer Shea

Vice-President, Communications, Investor & Government Relations

Rick Sutin

Corporate Secretary (interim)

Gary Weber, Ph.D.

President, Bioniche Food Safety (U.S.)

STOCK LISTING:**Toronto Stock Exchange**

Symbol: BNC

LEGAL COUNSEL:**Ogilvy, Renault**

Toronto, Ontario, Canada

AUDITORS:**Ernst & Young, LLP**

Montréal, Québec, Canada

TRANSFER AGENT:**CIBC Mellon Trust Company**

P.O. Box 7010

Adelaide Street Postal Station

Toronto, Ontario M5C 2W9

Tel: (416) 643-5500

Toll-free: (800) 387-0825

Fax: (416) 643-5501

SHAREHOLDER INQUIRIES:

Inquiries related to stock transfer or lost certificates and notices of address change should be directed to the Transfer Agent noted above. General information regarding the Company, recent news releases, and SEDAR filings are available via the Company's internet website at www.Bioniche.com, through the Corporate Communications, Investor and Government Relations office at (613) 966-8058, or by e-mail at info@Bioniche.com.

GENERAL & INVESTOR INQUIRIES:**Jennifer Shea**

Vice-President, Communications, Investor & Government Relations

Bioniche Life Sciences Inc.

P.O. Box 1570

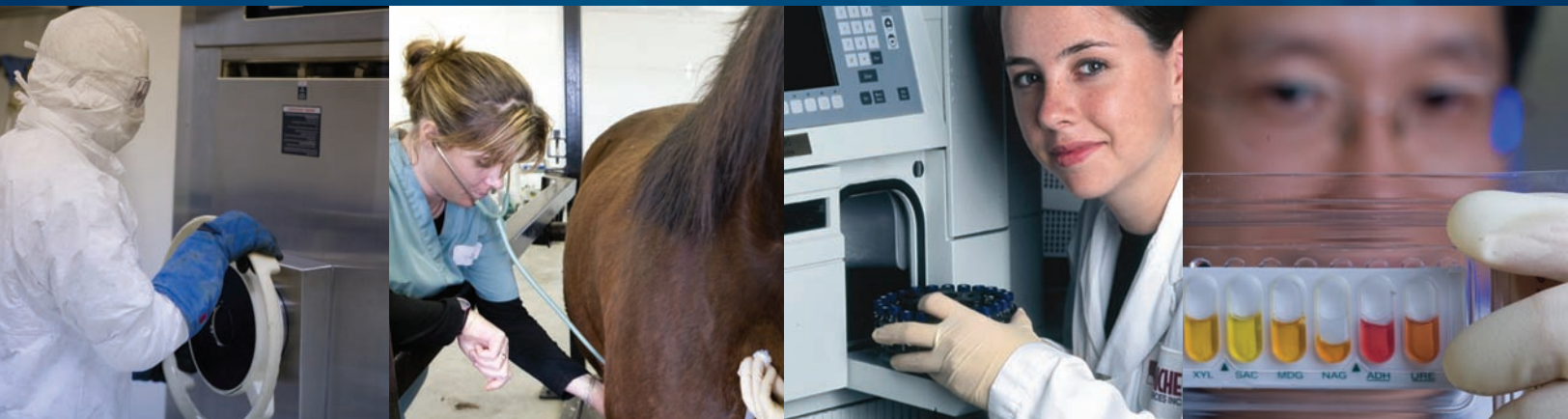
Belleville, Ontario, Canada

K8N 5J2

Tel: (613) 966-8058 ext. 1250

Fax: (613) 966-4177

Jennifer.Shea@Bioniche.com



www.Bioniche.com



P.O. Box 1570
Belleville, Ontario
Canada, K8N 5J2

Tel.: 613 966-8058
Fax: 613 966-4177