

ANNUAL REPORT | 08

Acting on Innovation



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, peritoneal 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 conditionally licensed • 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 1999. 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 200 individuals.

Fiscal 2008 Financial Highlights

CONSOLIDATED RESULTS AT A GLANCE

(expressed in millions of Canadian dollars)

Income Statement Highlights	2008
Revenues	27.7
Gross margins overall	57%
Operating Expenses	17.7
Loss before research and development and other expenses	(1.9)
Research and development expenses, net	14.1
Net loss and comprehensive loss for the year	(16.3)
Basic net loss per share	(0.26)
EBITDA* before research and development	1.3

* Earnings before interest, taxes, depreciation and amortization

AREAS OF MARKET FOCUS

(expressed in millions of Canadian dollars)

		2008
		\$
Animal Health	Reproduction	18.5
	Immune Stimulants	1.9
	Osteoarthritis	0.4
Food Safety	Revenues from areas of market focus	20.8
	Others & non-proprietary	6.9
Total revenues		27.7

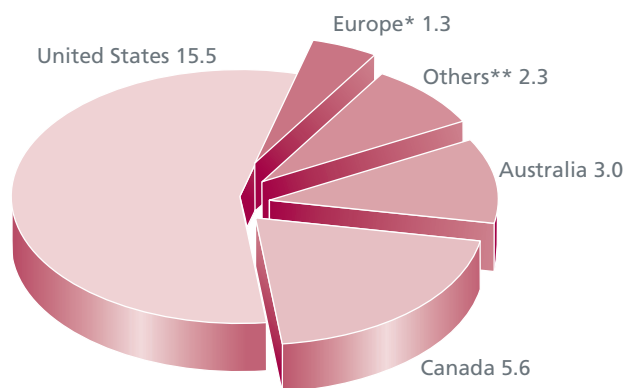
Business strategy

Bioniche Life Sciences Inc. operates as a fully-integrated business, combining research and development of high potential technologies with business units that generate revenues. Revenue streams have allowed the Company to balance risk, drive innovation, and support corporate growth as its proprietary technologies come through late stage development, ready for commercialization.

The Company's infrastructure is well-developed and experienced, allowing Bioniche to conduct scientific discovery, pre-clinical research, manufacturing, clinical studies, as well as regulatory submissions and product registrations in global jurisdictions.

Geographic Distribution of Revenues

expressed in millions of Canadian dollars

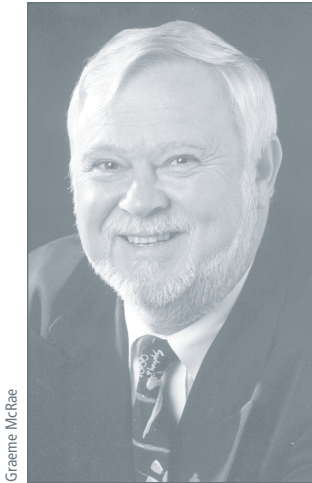


*Europe primarily includes Switzerland, Germany, Spain, the Netherlands, Ireland and the United Kingdom.

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

Bioniche believes in taking its proprietary technologies to their latest possible stage of development before seeking strategic external partners to assist in marketing the resulting commercialized products.

The Company has a pipeline of technologies in each business unit in early stage development to follow its priority projects — Mycobacterial Cell Wall-DNA Complex (MCC) for human bladder cancer treatment and *E. coli* O157 cattle vaccine — once they are further advanced.



Graeme McRae

Dear Fellow Shareholders,

As a biopharmaceutical company approaching 30 years of age, Bioniche is a rare breed. Few biotech/biopharma companies survive one decade, let alone three, in Canada or anywhere else. It's the nature of our industry; the challenge to survive and prosper in often difficult financial, regulatory and competitive environments. Numerous factors, many external to the company, can influence the progress of a project. In a world where investors are expecting (often demanding) a return on their investment in a relatively short length of time, many biotech/biopharma companies are forced to liquidate assets too early in their development timeline — in an often fruitless attempt to meet short-term expectations.

In Canada, there are more than 500 biotech companies, many of which are start-ups that have been spun out of universities, where researchers have discovered something novel in the lab and attempt to develop it. The Canadian government, largely through subsidies to university researchers, has invested more than \$23 billion in this technology sector over the last 20 years. Private investors have likely provided as much again. Given that the average human health product costs an estimated \$900 million to develop for marketing (Tufts Center for Drug Development, 2003), Canada should have seen more than 20 products commercialized. In fact, perhaps a half-dozen have made it to the market. This is due, in part, to the failure of some therapeutic candidates. However, it is more attributable to the sell-off of technologies at early stages to crystallize value. Most investors are not patient enough to await the estimated five to 12 years it can take to bring a product from early stage testing to market. Our industry in Canada shies away from taking products all the way through to commercialization. Not Bioniche.

Since I started the company in 1979, I was mindful of the value proposition in our industry. The greatest value comes from controlling products from their inception (whether in-house or acquired), through development, to commercialization. Partnerships with others can occur at any point, but these partnerships should be structured such that the company retains control over sufficient elements to ensure their successful launch. For example, it is our intention to retain control over the manufacture of Urocidin™, our therapeutic for bladder cancer. We know how to manufacture *Urocidin* and have successfully produced it and its predecessor products for 20 years. To hand over the process to an external party with no experience in this type of production could well result in it never making it to the market.

Urocidin™ Partnering Discussions

We have, for some time now, been having discussions with parties interested in a partnering transaction related to *Urocidin*. We are seeking a partner that will help to financially support the completion of our Phase III program in return for marketing rights to the commercialized product. We are seeking a substantial royalty stream that would flow back to Bioniche from product sales. Our intent is to maintain manufacturing rights for the product and a very substantive role in all aspects of its remaining development.

During the course of discussions with potential partners, it has become evident that, in general, there is a lack of understanding of the bladder cancer market. We believe this is largely due to there having been no new therapeutic treatments in 30 years and the resultant lack of reference data or independent market research. For a time, we did not realize this comparatively low level of awareness among the multinational firms and, for that matter, even the specialty pharmaceutical companies. We had difficulty understanding why the first proposals discussed at that time did not meet our expectations in matters such as market size and penetration. Since then, following closer engagement with Bioniche, we have been successful in reaching a better level of understanding with prospective partners about the market potential for *Urocidin*. The partners with whom we

are currently in discussion have, on the whole, agreed with our analyses as to patient numbers, target pricing and potential unit sales volumes. For those parties, their internal approval processes and resource allocations appear to be the principal remaining hurdles to a transaction.

Current Bladder Cancer Treatment and its Limitations

Bladder cancer is the 4th most common cancer in men and the 9th most common in women, according to the American Cancer Society (2007). Between the U.S. and the EU 25, approximately 142,000 people are newly-diagnosed with non-muscle-invasive bladder cancer each year. The incidence is expected to increase by 11% in the seven major global pharmaceutical markets between 2004 and 2012.

The primary current standard of care for high grade non-muscle-invasive bladder cancer (formerly known as superficial bladder cancer) is BCG, a live, attenuated strain of *Mycobacterium bovis*, the organism responsible for tuberculosis in cattle. Treatment with BCG is known to cause serious adverse events, which can force many patients to discontinue the therapy. The mycobacterium BCG is viable (live), and patients are also at risk for systemic infections, including life-threatening sepsis and even tuberculosis (the latter if the bacteria become localized in the lungs). A small, but significant, number of patients instead receive local chemotherapy as first-line treatment, which can be associated with other adverse reactions and, in some cases, myelosuppression. Not surprisingly, there is need and demand for a safer and more effective product for the treatment of non-muscle-invasive bladder cancer.

In patients with bladder cancer that is refractory (unresponsive) to BCG, there are few treatment options. The only other approved therapy is *Valrubicin*, which has a response rate of between 9% and 16%, leaving most patients without a successful treatment. Beyond its efficacy limitations, Valrubicin is not available due to ongoing manufacturing problems. Of course, surgical removal of the bladder is a last option as tumours progress, but is a major surgery that has dramatic quality of life implications for the patient, including the risk of death, a likelihood of post-operative complications, long-term care requirements, stoma maintenance, catheter use, urinary incontinence, reduced self-esteem, and an impact on sexuality.

In first-line (newly-diagnosed) non-muscle-invasive bladder cancer, patients, the tolerance of clinically-proven BCG regimens is limited and few patients complete a full scheduled induction and maintenance program (17% complete a 3-year maintenance program: Lamm, 2000). Between 20% and 30% of patients withdraw from treatment during the induction phase (first six weeks). BCG-induced cystitis, which affects more than 45% of treated patients, is one of the main reasons that patients halt therapy. For those who can tolerate the treatment, approximately 65% respond after the first course of treatment, with half expected to face tumour recurrence within five years.

An Alternative: Urocin™

Urocin is a formulation of Mycobacterial Cell Wall-DNA Complex (MCC), a cell wall-DNA composition prepared from a pure culture of the bacterium *Mycobacterium phlei*, a soilborne, non-disease causing bacterium. The cell wall complex has been fractionated and purified to optimize the presence of the active principal component of the molecule, DNA, which is partially responsible for its immunomodulatory and direct anti-cancer activities.

New data comparing the direct anticancer activity of MCC and of BCG against human bladder cancer cell lines was presented at the American Urological Association Annual Meeting, held in Anaheim, California, U.S.A. in May, 2007. This data showed that compared to live BCG, the anticancer activity of MCC towards three human bladder cancer cell lines was uniform, and only required short exposure times. In contrast, the direct anticancer activity of BCG was variable, and required prolonged incubation times not typical of those possible in the clinic. These data, in conjunction with data on cytokine induction, demonstrates that MCC possesses an activity profile that greatly distinguishes it from BCG.

Our Phase III clinical program consists of two registration trials.

First Phase III Pivotal Trial

Recruitment of patients continues in our first pivotal Phase III clinical trial with *Urocidin*. In this trial, patients with non muscle-invasive bladder cancer whose cancer is specifically refractory (unresponsive) to BCG will receive *Urocidin* in an open label study. Thirty-one urology centres in North America are participating in this study and enrolment is expected to be completed in the first quarter of calendar 2009.

The patients at participating sites that are eligible and who choose to participate in this trial represent a very small subset of the BCG refractory patient population in North America. In order to satisfy regulatory authorities, the trial protocol is quite specific and patients must meet numerous criteria to be eligible. A significant proportion of patients who appeared to qualify based upon local pathology assessment (per normal clinical practice) were later found to have cancer of a different grade when assessed by a central pathologist (per the trial's protocol) and were subsequently disqualified. The number of these variances has delayed the completion of enrollment beyond the fourth quarter of calendar 2008; ultimately, 105 evaluable patients must be enrolled and disqualifications require the Company to recruit replacement patients. Data from the 105 evaluable patients involved in the trial, coupled with additional safety information to be collected from a comparative trial, will allow full results to be reported one year after recruitment is completed for the efficacy and safety datasets. These results may also support regulatory submissions under U.S. Food and Drug Administration (FDA)'s Accelerated Approval program.

The Data Safety Monitoring Committee has held five consecutive quarterly meetings, each of which has concluded with the Committee's recommendation that Bioniche "continue the trial unmodified". The role of this independent body is to confirm that the safety of enrolled patients is being appropriately addressed and that, from an efficacy point of view, there is an appropriate basis for continuing the trial.

The U.S. Food and Drug Administration (FDA) has granted a "fast track" designation to this clinical indication, indicating that the Company can expect an expedited review by the FDA following completion of the study. Fast tracked products generally are reviewed within six months of data submission (vs. up to 18 months for non-fast tracked products).

Second Phase III Pivotal Trial

The Company's second pivotal Phase III clinical trial using its proprietary *Urocidin* in newly-diagnosed (first-line) non-muscle-invasive bladder cancer at high risk of recurrence or progression, is expected to start enrolling patients once enrolment has been completed in the first Phase III trial.

This second trial will enrol approximately 800 patients in North America, Australia and Europe and is a double-blind, randomized study. It will compare MCC to BCG, the standard treatment for non muscle-invasive bladder cancer at high risk of recurrence or progression in first-line patients.

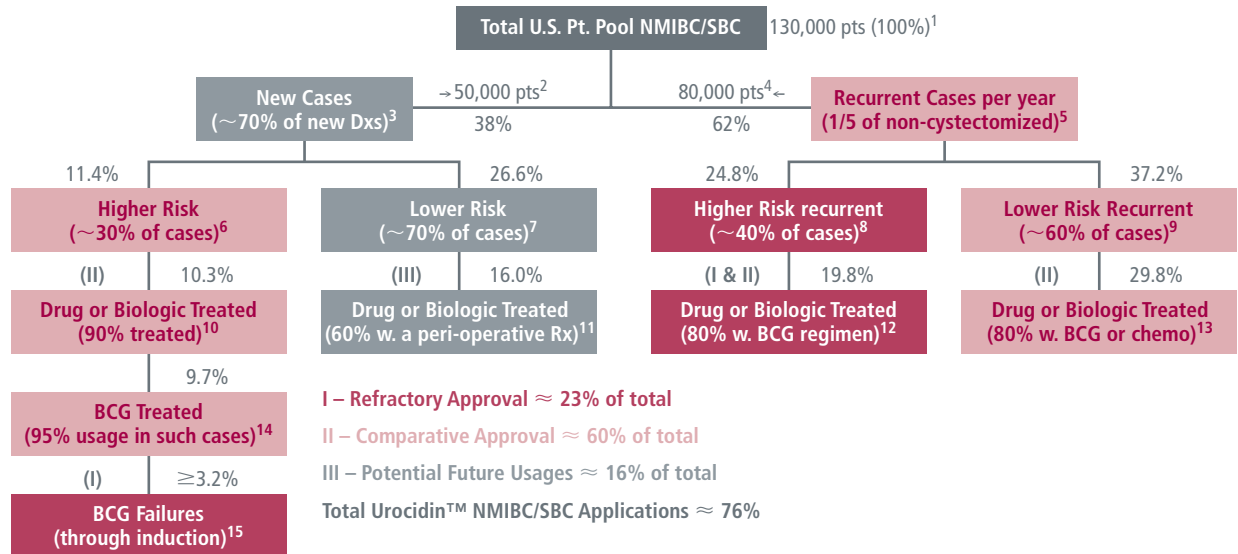
The U.S. Food and Drug Administration (FDA) granted a special protocol assessment (SPA) agreement related to the protocol for this trial. The SPA indicates agreement by the FDA on the design of the study, including its endpoints, data analysis and conduct. It provides assurance that, if the trial endpoints are met, they will serve as the basis for product approval under a Biologics Licensing Application (BLA). A SPA gives a clear pathway to registration of *Urocidin* when the study endpoints are achieved. The FDA also granted a "fast track" designation for this clinical indication.

The primary efficacy endpoint will be the duration of disease-free survival of patients after two years. In addition, safety will be evaluated based on two criteria: the percentage of patients who experience two consecutive delays of one week in treatment administration or have to abandon treatment due to drug-related adverse events; and through a comparative tabulation of drug-related adverse events. The overall goals will be to demonstrate non-inferior efficacy and improved safety of *Urocidin* over BCG.

Well-known urology centres are contacting us seeking an opportunity to participate in this clinical trial.

Market Opportunity

In the United States alone, approximately 90,000 patients (new and recurrent cases) are diagnosed with non-muscle-invasive bladder cancer each year. The chart below depicts the potential use of *Urocidin* within the different segments of this population. We expect that approval for *Urocidin* in the treatment of BCG-refractory cases will permit on-label use in 19% of non-muscle-invasive bladder cancer cases. Further clinical trials (and successful regulatory approvals) should expand this label to over 2/3rds of new and recurrent diagnoses. The Company expects that *Urocidin* could sell for approximately \$1,000 per dose.



***E. coli* O157 Cattle Vaccine**

During the course of Fiscal 2008, we announced the support from government and quasi-governmental sources for our *E. coli* O157 cattle vaccine in the form of \$25 million in low-interest loans toward the scale-up of an Animal Health and Food Safety Vaccine Manufacturing Centre in Belleville, Ontario. This gives us confidence as we proceed to generate increasing interest in the vaccine by industry, veterinarians, retailers and consumers. It demonstrates the recognition by government of the importance of vaccine production capacity in Canada, as well as the need for on-farm food safety solutions such as our *E. coli* vaccine.

With the \$25 million capital financing in hand, we have proceeded to complete engineering drawings for the production scale-up, initiate detailed design work, clear appropriate space within our existing facility in Belleville, order equipment, and hire production staff. Construction will be completed by late 2009, after which validation of systems and equipment will occur. The new facility is expected to be on-line and producing *E. coli* O157 vaccine by mid-2010. Production capacity will be a minimum of 40 million doses per year from this facility.

In the interim, demand for vaccine is being met through our Product Development Laboratory in Belleville. This lab is able to produce approximately one million doses per year.

Should demand warrant, we may provide additional bulk vaccine through a contract manufacturer. Discussions are underway in this regard.

Regulatory Update

We are undertaking the steps necessary to progress the *E. coli* vaccine to a full Canadian license and a conditional U.S. license.

Subsequent to year end, on September 24, 2008, we announced that the data package for our *E. coli* vaccine provided definitive evidence that the vaccine meets the efficacy and safety requirements for full licensing of the vaccine by the CFIA. As part of standard licensing requirements, we are required to complete quality control tests on three pre-commercial batches to verify consistency of manufacturing processes before a full license will be issued by the regulator. In the interim, we are selling limited quantities of vaccine to Canadian veterinarians under the CFIA's *Permit to Release Veterinary Biologics Regulations* granted in December, 2006.

The February, 2008, notice from the United States Department of Agriculture (USDA) that the latest data for our *E. coli* O157 cattle vaccine "meets the 'expectation of efficacy' standard" and is eligible for a conditional license prompted some further work on our part. In order to receive the conditional license, we must develop a plan to "collect sufficient data to move the product to full licensure" and make three vaccine batches with one manufacturing step completed in a U.S. facility. These activities are underway.

The regulators on both sides of the North American border are wrestling with the large amount of research data that has been provided to them related to this vaccine. We understand the regulators' challenge in handling the first vaccine technology of its type, where the improved health of the vaccinated animal is not at issue, nor is it an expected outcome. This *E. coli* is harboured by cattle, but does not make cattle ill as they do not have the receptor for the toxin the bacterium carries. Humans do have this receptor, so that if infected with the bacterium through contaminated food, water, or environment, they can become extremely ill, and some can die.

We believe that there has been more scientific data generated with this cattle vaccine than any other cattle vaccine prior to achieving full registration.

Market Interaction/Potential

Our food safety marketing team continues to meet with potential customers for the vaccine, including beef producers, feedlot operators, slaughterhouse operators, and cattle producer organizations. Under the current licensing scenario, we are not allowed to formally promote the vaccine through advertising, nor are we allowed to use the trade name, however, we are allowed to provide information to potential customers, including published results of field and challenge studies with the vaccine.

During Fiscal 2008, the Company announced that two articles have been published in a peer-reviewed journal, the *Journal of Food Protection*, both in regard to the efficacy of the Company's *E. coli* O157 cattle vaccine. The two articles related to field challenge studies conducted at the University of Nebraska-Lincoln involving close to 900 animals in 2002 and 2003. Further publications are pending that support the vaccine's efficacy.

The largest accessible pre-harvest market segment is cattle in feedlots. With approximately 30 million head of fed and non-fed cattle harvested annually in the U.S., there is a 60 million dose market potential in this segment. This is a highly price sensitive segment, requiring high service and reliable supply. Use of the vaccine requires strong support as the feedlots will be paying for something with no offsetting increase in income for the sale of their animals.

The cow/calf and dairy segments represent large numbers of animals (approximately 30 million beef cows and 30 million beef calves; 9 million dairy cows and 9 million dairy calves annually). The main *E. coli* O157:H7 concern from this segment is contamination of the environment from run-off, with the potential of subsequent contamination of fruits and vegetables that have been irrigated with contaminated water. There have also been reported cases of *E. coli* O157:H7 in unpasteurized milk products.

Cases of human infection with *E. coli* O157:H7 have also been associated with people attending livestock events or petting zoos. Reported exposures often include hand contact with the mouth after touching an animal or coming in contact with the bacteria in the animal's environment. There are more than 3,000 fairs and many other venues where ruminant livestock events are held in North America each year. The total number of animals in livestock events or petting zoos is relatively small (less than three million), however, the value of the animals and the potential of legal liability is expected to stimulate adoption of vaccination for these animals.

Animal Health Business

The Bioniche Animal Health Division has grown by using biotechnology to provide this animal health market with a portfolio of more than sixty products, which can be grouped into the following categories: Reproduction and embryo transfer; Hyaluronan-based; Immunostimulants; Polyclonal antibodies; Vaccine products; and Nutraceuticals. Revenues are approaching \$30 million/year at a gross margin of around 60%. The animal health business has grown slowly over the past several years under the pressure of such issues as "Mad Cow Disease" and currency fluctuations. However, it is poised for future growth at such time as additional resources can be applied to it. During Fiscal 2008, under the leadership of Jim Phillips, President of Bioniche Animal Health (global), the division has undergone some restructuring to better position it for this future growth.

Liquidity

Subsequent to year end, we announced that we allowed the conversion of a portion of our revolving credit facility with the Laurus/Valens family of funds into common shares. Converting US\$1.85 million of the revolving facility into equity provided approximately \$2 million Cdn. of additional borrowing capacity under the credit line. This is a useful addition to our cash flow as we work to achieve our near-term milestones. Laurus/Valens has been, and continues to be, a very supportive banker.

Outlook for Fiscal 2009

Our primary goals remain: The North American licensing of our *E. coli* O157 vaccine; the successful completion of our Phase III clinical program with *Urocidin* in non-muscle-invasive bladder cancer; and the successful conclusion of a marketing partnership agreement for *Urocidin*. Further, we are focused on the need to ensure adequate funding to maintain momentum around these projects. Beyond a *Urocidin* partnership transaction, we are also considering other minimally-dilutive financing instruments to support our operating requirements.

We employ close to 200 committed and skilled employees across our organization and we are fortunate to have the leadership of a qualified and supportive Board of Directors, all of whom are working together toward our corporate goals.

We look forward to your continuing support as we work to achieve these objectives.



Graeme McRae

Chairman, President & CEO

The following discussion and analysis is the responsibility of management and should be read in conjunction with our audited consolidated financial statements as at June 2008 and 2007 and related notes thereto which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). It is intended to complement and supplement financial information included in Bioniche Life Sciences Inc.'s [the "Company's" or "Bioniche's"] interim and annual consolidated financial statements, related notes, other financial information found elsewhere in our annual report and in our annual information form or other documents filed on SEDAR at www.sedar.com.

The discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. The Company's future results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed under "Risks and Uncertainties".

This management's discussion and analysis is current as at September 26, 2008. Where "we", "us", "our", "Bioniche" or the "Company" are utilized, these mean Bioniche Life Sciences Inc. unless otherwise indicated. All amounts are presented in Canadian dollars 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.

The Company has continued to experience a challenge in its financial condition and liquidity during Fiscal 2008 and anticipates a continuation of this challenge in Fiscal 2009. Further discussion on the going concern uncertainty is provided in the section "Liquidity, Financing, and Capital Resources".

Overview

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 fully-integrated Company employs 201 people and has three operating business units: Human Health, Animal Health, and Food Safety. Corporate headquarters are located in Belleville, Ontario, Canada. The Company's human health business unit has research and production facilities in Montréal, Québec, Canada. The animal health business unit has product development, manufacturing and marketing facilities in Belleville, Ontario, Canada; marketing and production facilities in Athens, Georgia, USA; Pullman, Washington, USA; and Armidale, Australia; as well as a sales and marketing office in Ireland.

The Company has several areas of strategic focus, including the develop-

ment of its proprietary technologies for human bladder cancer and other cancers; a cattle vaccine to help reduce *E. coli* O157:H7 contamination of food, water and the environment; technologies to improve livestock reproduction; and technologies that could replace the use of antibiotics in livestock. The Company's Animal Health business unit is global in scope.

Business Strategy

The Company has a three-fold strategy. First, it takes its existing proprietary technologies and continues, through its product development programs, to enhance their proven therapeutic value for human and animal use. Second, the Company works to develop these technologies to the point of commercialization, either alone or with strategic marketing partners. Third, the Company manufactures as many products emerging from the product development program as it can to increase profit margins, protect the integrity of its products, and enhance shareholder value.

The structure of the Company is such that its key research and development projects are supported by a revenue-generating business — 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. The Human Health business unit and the Food Safety unit require cash for their operations and research and development projects.

Business Units

The Company's operations are organized into three strategic business units:

Animal Health

The Company's animal health business is operated through the Bioniche Animal Health business unit, which is responsible for developing, manufacturing and marketing animal health biopharmaceutical products worldwide. The Company's animal health products are marketed directly to veterinarians in Canada, the United States, Australia and Europe, and through selected distributors in the rest of the world. Bioniche Animal

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

Health operates marketing, production and research facilities in Belleville, Ontario, Canada; marketing and manufacturing units in Athens, Georgia and in Pullman, Washington in the United States; a manufacturing facility in Armidale, New South Wales, Australia; and a sales and marketing office in Ireland with distributors in many other jurisdictions around the world.

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 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 hyaluronan; immunostimulant products; polyclonal antibodies; vaccine products; and nutraceuticals.

Human Health

The Company's human health business is operated through the Bioniche Therapeutics business unit and has research and production facilities in Montreal, Quebec, Canada. This division develops novel and proprietary human cancer therapies. The Company's strategy is to develop its therapies through clinical proof of concept and then to establish alliances to complete clinical studies and regulatory approvals for marketing. The focus of activity is on the research and development of the Company's proprietary 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. Trademarked *Urocidin* for bladder cancer, the MCC technology is currently in Phase III clinical testing in patients with non-muscle-invasive bladder cancer that is refractory (unresponsive) to the standard therapy. A second Phase III study, comparing *Urocidin* to the standard therapy in patients with non-muscle-invasive bladder cancer as a first-line treatment, is planned.

Food Safety

The Food Safety business unit of the Company was established in July, 2001. The division is responsible for researching, developing, manufacturing and marketing of veterinary biopharmaceutical products to help improve the safety of food and water supplies. The lead initiative for this division is the development and commercialization of a new cattle vaccine to prevent the colonization and spread of the deadly *E. coli* O157:H7 organism. This

vaccine is designed to reduce the burden of the pathogenic bacterium *E. coli* O157:H7 in cattle and their manure, thereby reducing contamination into the environment, ground water, and in cattle processing plants. The vaccine has proven 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 in production in limited quantities in the Company's Belleville, Ontario facility, 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. The inability to promote the product prior to full regulatory approval and limited production capacity at present has constrained sales to date.

The Company, in partnership with the Vaccine and Infectious Diseases Organization (VIDO) at the University of Saskatchewan and the 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* and *Campylobacter jejuni*.

Management Objectives

The Company's goal is to execute the Company's business strategy:

1. Take existing proprietary technologies and continue, through the product development program, to enhance their proven therapeutic value for human and animal use.
2. Work to develop these technologies to the point of commercialization, either alone or with strategic marketing partners.
3. Manufacture 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 2008 Objectives	Status
<ul style="list-style-type: none"> • Generate cash flow by increasing revenue and productivity, as measured by the consolidated EBITDA* in the Animal Health business unit. 	<ul style="list-style-type: none"> • The Company is meeting this objective. The Animal Health EBITDA* has shown an increase of 14% for the year ended June 30, 2008 when compared with the same period in Fiscal 2007.
<ul style="list-style-type: none"> • Progress to a full Canadian license for the <i>E. coli</i> O157 cattle vaccine, while selling available vaccine (limited quantities) to Canadian veterinarians under the <i>Permit to Release Veterinary Biologics</i> and continuing to pursue registration in the U.S. 	<ul style="list-style-type: none"> • During this fiscal year, the Company was granted eligibility for a U.S. conditional license. • The Company is in discussions with regulators in Canada and the U.S. in order to facilitate the progress of our vaccine registrations in both jurisdictions. • The Company was advised by the Canadian Food Inspection Agency (CFIA) that the data package for the <i>E. coli</i> vaccine provided definitive evidence that the vaccine meets the efficacy and safety requirements for full licensing of the vaccine. As part of standard licensing requirements, the Company is required to complete quality control tests on three pre-commercial batches to verify consistency of manufacturing processes before a full license will be issued by the regulator.
<ul style="list-style-type: none"> • Begin to scale-up vaccine production at the Company's Belleville facility. This two-year project is expected to have an annual capacity of 40 million doses of the <i>E. coli</i> O157 vaccine. The scale-up is expected to cost approximately \$25 million, the first phase of a long-term, \$107 million project to create an Animal Health and Food Safety Vaccine Manufacturing Centre. 	<ul style="list-style-type: none"> • The Company has secured government assistance in the form of interest free loans based on eligible expenditures from the Ontario Ministry of Economic Development and Trade ("AMIS" program) and Agriculture Canada (Agri-Opportunities program) in addition to a loan facility with the Business Development Bank of Canada ["BDC"] for the Phase 1 scale-up of a vaccine production facility in Belleville, Ontario. A total of \$25 million in funding and assistance was announced in December, 2007 and February, 2008.
<ul style="list-style-type: none"> • Successfully conclude a marketing partnership transaction for the Company's bladder cancer technology. 	<ul style="list-style-type: none"> • The Company is in ongoing discussions with potential marketing partners and has identified several options with regard to financing future corporate development in the event that a marketing partnership transaction is not concluded in the near term. • For more information on those please refer to the "liquidity" section below.

** EBITDA means "Earnings Before Interest, Taxes, Depreciation, Amortization and foreign exchange". For more information please refer to the section, "Non-GAAP & Other Measures" below.

Liquidity

The Company has incurred significant losses since its inception, due primarily to its focus on the research and development of its proprietary technologies. The Company had an accumulated deficit of \$84.9 million as at June 30, 2008. The Company's committed cash obligations, exclusive of the subsequent event set out in Note 20 of the June 30, 2008 consolidated financial statements and expected level of expenses for the first half of Fiscal 2009 exceed the committed sources of funds and funds available as of June 30, 2008. To date, the Company has financed its cash requirements primarily through issuances of shares, investment tax credits, sales of businesses or business units, products sales, royalties, government incentives, long-term debt and its revolving credit facility.

As a result of the Company's near-term liquidity requirements, it is pursuing several financing alternatives including completing a partnership deal to support its Phase III development program for *Urocidin*; issuing additional debt, preferred or common equity, and finding strategic financing partners.

At the end of June 30 2008, the Company had cash and cash equivalents of \$4.4 million, along with approximately \$2.4 million available from the existing revolving credit facility and a net working capital balance of \$4.5 million. Subsequent to the year end, on September 9, 2008, the Company converted a portion of its revolving debt facility into equity, which allows further borrowing

of an additional US\$1.85 million. Following this transaction, and based on the current estimated cash requirements, there is still significant uncertainty surrounding the Company's ability to continue as a going concern, and there remains a near-term need to obtain additional financial resources. The Company's ability to continue as a going concern is dependent upon successful completion of one or more of its available financing alternatives in the near-term, the successful sale of its existing products at positive margins, and its success in obtaining regulatory approvals and bringing new products to market to achieve profitable operations in the future. The outcome of these matters is dependent upon many factors outside of the Company's control. If the Company is unable to obtain additional financing, management may be required to curtail the Company's development activities and operations.

Highlights for Fiscal 2008

Operating Highlights

- On August 24, 2007, the Company announced that the **first permit had been issued for its *E. coli* O157 cattle vaccine (trademarked *Econiche*)**, and that the first order of vaccine had been shipped to that customer.
- On September 10, 2007, the Company announced that **an agreement had been reached with the U.S. Food and Drug Administration (FDA)** under the Special Protocol Assessment (SPA) procedure relating to the Company's pivotal Phase III study using its proprietary Mycobacterial Cell Wall-DNA Complex (MCC) in non-muscle-invasive bladder cancer at high risk of recurrence or progression. A SPA gives a clear pathway to registration of *Urocidin*[™] when the study endpoints are achieved.
- On February 5, 2008, Bioniche received notice from the United States Department of Agriculture (USDA) that the **latest data for its *E. coli* O157 cattle vaccine "meets the 'expectation of efficacy' standard" to be granted a conditional license**, providing that the Company develops a plan "that would collect sufficient data to move the product to full licensure". The conditional license, when granted, will provide the Company full access to the U.S. market with certain restrictions.
- On March 4, 2008, the Company announced that its therapy for first-line non-muscle-invasive bladder cancer **meets the criteria for Fast Track designation**. A Phase III clinical trial comparing a formulation of the Company's Mycobacterial Cell Wall-DNA Complex (MCC) — *Urocidin*[™] — to the current standard therapy in patients with non-muscle-invasive bladder cancer at high risk of recurrence or progression is planned. This

clinical trial, scheduled to begin later in 2008, aims to demonstrate superior efficacy with respect to disease-free survival and fewer toxicities than the current standard therapy.

- August 18, 2008, the Company announced that **The Data Safety Monitoring Committee held its fifth meeting regarding this clinical trial, recommended that Bioniche "continue the trial unmodified"**. The role of this independent body is to confirm that the safety of enrolled patients is being appropriately addressed and that, from an efficacy point of view, there is an appropriate basis for continuing the trial.
- On September 24, 2008, the Company announced that the data package for its *E. coli* O157 vaccine provided definitive evidence that the vaccine meets the efficacy and safety requirements for full licensing of the vaccine by the CFIA. As part of standard licensing requirements, the Company is required to complete quality control tests on three pre-commercial batches to verify consistency of manufacturing processes before a full license will be issued by the regulator.

Financial Highlights

- On September 7, 2007, the Company announced that it had **received a \$2 million grant from the Rural Economic Development (RED) Program of the Ontario Ministry of Agriculture, Food and Rural Affairs**. The grant, which is based on a percentage of eligible expenditures, will be applied to support the market development expenditures incurred related to the Company's *E. coli* O157 cattle vaccine.
- On December 18, 2007, the Company announced that it **had received \$10 million in Ontario government financing** in support of its vaccine production facility scale-up in Belleville, Ontario, Canada. The \$10 million loan, disbursements under which are based on a percentage of eligible expenditures, is being provided through the Ministry of Economic Development and Trade (MEDT)'s Advanced Manufacturing Investment Strategy (AMIS).
- On December 20, 2007, the Company announced that it had **received \$5 million in federal government financing in support of its vaccine production facility scale-up**. The \$5 million loan, disbursements under which are based on a percentage of eligible expenditures is being provided through the new Agri-Opportunities Program of the Department of Agriculture and Agri-Food (Canada) (AAFC).
- On December 21, 2007, the Company announced that it had **amended its revolving credit facility with Laurus Master Funds**. Under the amended facility, the Company has a maximum borrowing limit of US\$5.5 million of which \$US 3 million is unrestricted, versus the previous maximum of

US\$4.0 million. With reduced restrictions this amendment represented an immediate increase to available funds of US\$3.0 million as there are no restrictions based on asset base calculation for these additional funds.

- On February 8, 2008, the Company entered into a ten-year **term loan agreement with the Business Development Bank of Canada (BDC) for \$5 million**. This loan is collateralized by certain property, plant and equipment at the Company's Belleville, Ontario facility and is subject to certain financial and non-financial covenants. At June 30, 2008, \$1.750 million has been drawn with future draws based on certain qualified expenditures.
- On March 27, 2008, the Company **announced the conversion of a portion of its revolving credit facility** with Laurus/Valens, issuing 2.7 million shares. The conversion was in accordance with the formula set out in the original agreement signed in 2005. In addition, the Company agreed to issue 200,000 five-year warrants to purchase common shares with an exercise price of \$0.77 per common share, in exchange for Laurus/Valens waiving certain volume restrictions relating to the conversion under the agreement.
- On June 25, 2008, the Company announced an **amendment to a pre-existing \$7.6 million contribution agreement with the Industrial Technologies Office of Industry Canada** that will support the scale-up of its vaccine production facility in Belleville, Ontario. This funding will be combined to the other project financing announced above. With \$25 million in funding through a loan and various government assistance programs in place, the Company has the required financing to commence the scale-up of vaccine production at its Belleville facility over the next two years. This will provide capacity of a minimum of 40 million doses of the *E. coli* O157 vaccine per year. It is part of a long-term, \$107 million project to create a state-of-the-art Animal Health and Food Safety Vaccine Manufacturing Centre in Belleville.
- In a subsequent event, on September 9, 2008, the Company **announced the conversion of a portion of its revolving credit facility with Laurus/Valens, issuing 4.6 million shares and freeing up US\$1.85M** in additional borrowing capacity. The conversion is in accordance with the formula set out in the original agreement signed in 2005. In addition, the Company will issue 211,429 five-year warrants to purchase common shares with an exercise price of \$0.49 per common share in exchange for Laurus/Valens waiving certain volume restrictions on the conversion of borrowings into common shares set out in the agreement.

In Other News:

- On September 27, 2007, the Company announced that its vaccine against *E. coli* O157:H7 in cattle had been recognized internationally as the **best new veterinary product for livestock** by the Animal Pharm industry excellence awards.
- On November 13, 2007, the Company announced that two articles have been published in a peer-reviewed journal, the **Journal of Food Protection**, both in regard to the efficacy of the Company's *E. coli* O157 cattle vaccine. The two articles related to field challenge studies conducted at the University of Nebraska-Lincoln involving close to 900 animals in 2002 and 2003.
- On December 4, 2007, the Company was honored as one of **Canada's Top 10 Life Sciences Companies for 2008**. The Company was chosen by a group of distinguished venture capital investors based on the Company's attractiveness as an exceptional investment in Canada.
- On April 21 2007, the Company announced the **appointment of Dr. Gary Weber as President, Bioniche Food Safety (U.S.)**. Dr. Weber brings a wealth of experience to this position, having worked for the United States Department of Agriculture (USDA) as National Program Leader for Animal Science; the National Cattlemen's Beef Association as Director of Animal Health, Inspection and Science Policy and Executive Director of Regulatory Affairs.
- During the year, the Company has attracted the coverage of three equity research analysts:
 - **Crystal Research Associates, LLC**. The full 68-page report can be found at www.crystalra.com.
 - **Fraser Mackenzie**. The full 57-page report can be found at www.frasermackenzie.com.
 - **Haywood Securities**. The full 73-page report can be found at www.haywood.com.

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)

	2008		2007	
	\$	%	\$	%
Revenues	27.7	100%	27.5	100%
Cost of Sales	11.9	43%	12.2	44%
Gross Profit	15.8	57%	15.3	56%
Expenses				
Administration	6.7	24%	7.2	26%
Marketing and Selling	7.0	25%	6.1	22%
Quality Assurance	0.8	3%	0.7	3%
EBITDA* before Research and Development	1.3	5%	1.3	5%
Net Research and Development	14.1	51%	13.2	48%
Interest, taxes, depreciation, amortization and other items**	3.5	13%	2.9	10%
Net loss and comprehensive loss for the year	(16.3)	-59%	(14.8)	-53%

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

** other items includes the net gain on the sale of investment

Year Ended June 30, 2008 as Compared to the Year Ended June 30, 2007

Consolidated Revenue

The Company's consolidated revenues for Fiscal 2008 reached \$27.7 million as compared to \$27.5 million for Fiscal 2007. This represents a 0.7% increase, which can be attributed to increased sales in the U.S. and European markets.

Cost of Goods Sold

For the year ended June 30, 2008, gross profit totalled \$15.8 million compared to \$15.3 million for the year ended June 30, 2007. For year ended June 30, 2008, gross profit as a percentage of sales totalled 57.2% compared to 55.6% for fiscal 2007. The gross profit margins increased this fiscal year as a result of improved efficiencies and increased sales of higher margin products.

Expenses Other than Research and Development

EXPENSES OTHER THAN RESEARCH AND DEVELOPMENT AND OTHER ITEMS

(expressed in millions of Canadian dollars)

	Year to date			
	2008		2007	
	\$	%	\$	%
Revenues	27.7	100%	27.5	100%
Expenses				
Administration	6.7	24%	7.2	26%
Selling and Marketing	7.0	25%	6.1	22%
Quality Assurance	0.8	3%	0.7	3%
<i>Sub total</i>	14.5	52%	14.0	51%
Non cash items				
Amortization	2.8	10%	3.1	11%
Accreted interest	(0.0)	0%	0.7	3%
<i>Sub total</i>	2.8	10%	3.8	14%
Other items				
Interest	0.2	1%	0.7	2%
Foreign Exchange	0.2	1%	0.0	0%
<i>Sub total</i>	0.4	2%	0.7	2%
Total Expenses	17.7	64%	18.5	67%

For the year ended June 30, 2008, expenses before research and development totalled \$17.7 million, compared to \$18.5 million for fiscal 2007. This decrease of \$0.8 million, or 4%, reflects a reduction in interest and the amortization of deferred financing fees.

Research and Development

For the year ended June 30, 2008, research and development expenses totalled \$15.9 million, compared to \$14.9 million for Fiscal 2007. The majority of these costs can be attributed to the ongoing Phase III clinical program for the Company's Urocidin™ bladder cancer treatment and the *E. coli* O157 cattle vaccine development program.

GROSS RESEARCH & DEVELOPMENT

(expressed in millions of Canadian dollars)

For the three and twelve months ended June 30	Q4	2008		Q4	2007	
		\$	YTD		\$	YTD
Key Areas	\$	\$	%	\$	\$	%
Animal Health	0.5	1.9	12%	0.5	1.9	13%
Food Safety	0.8	2.6	16%	0.6	2.7	18%
Human Health	3.0	11.4	72%	2.4	10.3	69%
Research and Development, Gross	4.3	15.9	100%	3.5	14.9	100%

Consolidated Net Loss and Comprehensive Loss

For the year ended June 30, 2008, basic and fully-diluted loss and comprehensive loss per share totalled \$0.26, compared to a loss per share of \$0.32 for the corresponding period in Fiscal 2007. Total shares outstanding at June 30, 2008 were 65,782,510 as compared to 61,711,867 for the corresponding period in Fiscal 2007.

EBITDA* Before Research and Development Expenditures

CALCULATION OF EBITDA

(expressed in millions of Canadian dollars)

For the three and twelve months ended June 30	2008		2007	
	Q4 \$	YTD \$	Q4 \$	YTD \$
Income (loss) before research and development and other items*	(0.2)	(1.9)	(1.5)	(3.1)
Add (deduct):				
Amortization	0.9	2.8	0.6	3.1
Interest and Accreted interest	0.1	0.2	(0.0)	1.4
Foreign exchange	(0.0)	0.2	0.3	(0.1)
EBITDA before research and development	0.8	1.3	(0.6)	1.3

* other items include impairment/loss on investment, gain on sale of right to future royalty stream, unrealized loss (gain) on foreign currency embedded derivative

For the three-months and year ended June 30, 2008, EBITDA* before research and development totalled \$0.8 million and \$1.3 million respectively, compared to a loss of (\$0.6) million and \$1.3 million for the corresponding periods in Fiscal 2007.

* EBITDA means "Earnings Before Interest, Taxes, Depreciation, Amortization and foreign exchange". For more information please refer to the section, "Non-GAAP & Other Measures" below.

Q4 Highlights

The Company's consolidated revenues reached \$8.1 million for the fourth quarter of Fiscal 2008, as compared to \$7.5 million in the same period last year, due primarily to increased sales in the US and Europe.

The loss before research and development and other items of \$0.2 million during the fourth quarter of Fiscal 2008 represents a \$1.3 million improvement as compared to a loss of \$1.5 million for the same period in Fiscal

2007. This reflects increased sales in the fourth quarter this year of \$0.6 million, improved foreign exchange impact of \$0.3 million and reduced selling, marketing and administrative costs related to operations of \$0.9 million.

As a result, the total basic and fully-diluted loss per share for the final quarter of Fiscal 2008 was (\$0.06), compared to a basic and fully-diluted loss per share of (\$0.08) for the same period in Fiscal 2007.

Last Eight (8) Quarters Consolidated Results at a Glance

LAST EIGHT (8) QUARTERS CONSOLIDATED RESULTS AT A GLANCE

(expressed in millions of Canadian dollars)

	2008				2007			
	\$ Q4	\$ Q3	\$ Q2	\$ Q1	\$ Q4	\$ Q3	\$ Q2	\$ Q1
Revenues	8.1	7.2	6.5	5.9	7.5	6.4	5.9	7.7
Income (loss) before research & development and other items	(0.2)	(0.2)	(0.8)	(0.7)	(1.4)	(0.6)	(1.8)	0.6
Net loss	(3.7)	(4.6)	(4.2)	(3.8)	(4.7)	(4.5)	(2.9)	(2.7)
Basic and fully diluted net loss per share	(0.06)	(0.07)	(0.07)	(0.06)	(0.08)	(0.10)	(0.07)	(0.07)

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, and the timing of revenues from product sales. 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.

Consolidated Balance Sheet Highlights

Assets

The Company's current assets at June 30, 2008, totalled at \$16.3 million, as compared to \$22.7 million reported at June 30, 2007. The reduced level of assets results primarily from continued losses as the Company invests in advancing its late-stage core technologies. Overall, the Company maintained a burn rate* of approximately \$1.0 million per month for the fiscal years ending June 30, 2008 and June 30, 2007. Cash and cash equivalents and short-term investments totalled \$4.4 million at June 30, 2008, as compared to \$11.0 million at June 30, 2007.

Long-term assets at June 30, 2008, decreased to \$18.3 million, as compared to \$18.9 million reported at June 30, 2007. This decrease is attributed to reduced intangible assets which reflect current amortization. This is partially offset by capital asset additions during the year ended June 30, 2008 of \$1.4 million as compared to \$0.6 million during Fiscal 2007.

Liabilities and Shareholders' Equity

At June 30, 2008, the Company's net working capital totalled \$4.5 million, as compared to \$14.4 million at June 30, 2007. Shareholders' equity at June 30, 2008 totalled \$16.4 million as compared to \$29.1 million at June 30, 2007.

Long-term debt at June 30, 2008 totalled \$6.5 million. This compares to \$4.2 million reported in the same period last year. The increase reflects the additional BDC loan of \$1.2 million, additional capital leases of \$0.4 million and movement of deferred government incentives of \$0.5 million related to the *E. coli* project to long-term debt.

The Company has incurred significant losses and had an accumulated deficit of \$84,751,649 as at June 30, 2008. This compares to an accumulated deficit of \$68,630,615 at June 30, 2007.

Cash Flow Statement Highlights

The Company's cash flow used in operations remained stable at approximately \$11.7 million during Fiscal 2008, as compared to \$11.6 million in Fiscal 2007. This reflects the Company's continuing focus on completing Phase III clinical trials for *Urocidin* in the treatment of non-muscle-invasive bladder cancer technologies and achieving North American registrations for its *E. coli* O157 cattle vaccine.

The Company's financing activities provided cash of \$5.6 million during the fiscal year ending June 30, 2008, primarily as a result of \$1.75 million from the BDC loan facility and approximately \$4.1 million in net borrowing on the revolving credit facility. By comparison, in fiscal year 2007 ending June 30, 2007, \$11.8 million was provided primarily through the issuance of equity (see June 30, 2008 Consolidated Financial Statements, Note 13[c][i][iii]).

* Burn rate means cash flow used in operations. For more information, please refer to the section, "Non-GAAP & Other Measures" below.

Segmented Financial Performance

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

Human Health Segment

The Company no longer generates revenues from this segment since it sold its royalty income on sales of *Suplasyn* in Fiscal 2007. Last year's results included royalty revenues of \$0.5 million.

Gross research and development expenses for the year ended June 30, 2008 totalled \$11.4 million, which compares to \$10.3 million reported in the same period in Fiscal 2007. The year-to-date increase of \$1.1 million, or 10.7%, is primarily attributed to the increased recruitment of patients in the first Phase III bladder cancer registration trial and third party costs incurred to support the Company's Phase III clinical program.

Government incentives for the year ended June 30, 2008 totalled \$1.6 million, this compares to \$1.4 million recorded in the same period in Fiscal 2007.

Animal Health Segment

Animal health product sales increased by \$0.6 million, or 2.2%, to \$27.6 million for the year ended June 30, 2008, as compared to \$27.0 million recorded in the same period in Fiscal 2007. This reflects increased sales of *Folltropin®-V* in the U.S., European and global export markets, as well as *Cue-Mate* and *Pregnecol* in Australia. This was offset by reduced sales of *MAP®-5* in the U.S. and Australia.

Gross profit in the Animal Health segment for the year ended June 30, 2008 totalled \$15.8 million, or 57.2%, which compares to \$14.8 million, or 54.8%, reported in the same period in Fiscal 2007. This primarily reflects increased sales of higher margin products such as *Folltropin®-V* as well as positive adjustments made in the Australian operations that are reducing costs this fiscal year.

Expenses incurred in the year ended June 30, 2008 totalled \$8.1 million, which is the same amount reported in the same period last year. There were no major changes to administrative activities or expenses.

Gross research and development expenses in the year ended June 30, 2008 totalled \$1.9 million, the same amount reported in the same period in Fiscal 2007.

Subsequent to the end of Fiscal 2008, the Company reported that its product, *Immunoboost®*, an immunostimulant technology for calves, has been granted full listing by the Organic Materials Review Institute (OMRI). The addition of *Immunoboost* to the official OMRI list indicates that this

biological product has met the national standard for use in organic dairy and beef operations in the United States.

Food Safety Segment

This segment recorded its first sales during Fiscal 2008. Sales will remain limited by the Company's production capacity until the vaccine production facility in Belleville, Ontario is fully scaled-up. The Company announced a \$25 million expansion for the Belleville facility to accommodate large scale manufacturing production during fiscal 2008. Work is underway.

On December 18, 2007, the Company announced that it was eligible to receive up to \$10,000,000 in Ontario government financing in the form of a loan which will be interest-free until April 2013. This loan from the Ontario Ministry of Economic Development and Trade's 'Advance Manufacturing Investment Strategy' program will be based on eligible expenditures made by the Company since April 12, 2007, to scale up a vaccine production facility in Belleville, Ontario. Claims for funding related to eligible expenditures amounting to \$931,815 have been filed as at June 30, 2008.

On December 20, 2007, the Company announced that it was eligible to receive up to \$5,000,000 in federal government financing from the Department of Agriculture and Agri-Food (Canada) 'Agri-Opportunities' Program in the form of an interest-free loan based on eligible expenditures made by the Company since September 21, 2007, to scale up the aforementioned vaccine production facilities. The loan will be interest-free until fully repaid. Claims for funding related to eligible expenditures amounting to \$68,008 have been filed as at June 30, 2008.

In addition, the Industrial Technologies Office (ITO) of Industry Canada will provide certain amounts to the facility.

Expenses incurred in the year ended June 30, 2008 totalled \$1.7 million as compared to \$1.3 million reported in fiscal 2007. The Company is currently undertaking an education and awareness program focused on the dangers of *E. coli* O157:H7 and the importance of food and environmental safety. This initiative has been enhanced with the addition of Gary Weber as U.S. President of Food Safety, as discussed above.

On September 7, 2007, the Company announced an agreement for a \$2,000,000 government grant from the Rural Economic Development Program ["RED"] for market development related to its *E. coli* O157 cattle vaccine. As at June 30, 2008, the Company has recognized \$434,773 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 \$40,010 to its fair value of \$35,234 using a discount rate of 5.69% and reclassified it to long-term accounts receivable [Note 5[b]]. This discount will be amortized over the term that each claim amount is outstanding, using the effective interest rate method. The eligible amount less the discount has been netted against the related marketing expenses.

This segment incurred gross research and development expenses of \$2.6 million for the year ended June 30, 2008, as compared to \$2.7 million reported in Fiscal 2007. The Company has continued to pursue its development efforts while awaiting product approval from the relevant regulators in Canada and the United States.

GEOGRAPHIC DISTRIBUTION OF CONSOLIDATED REVENUES

(expressed in millions of Canadian dollars)

Revenues	2008 \$	2007 \$	Increase (decrease)
Canada	5.6	6.0	-7%
Europe *	1.3	1.6	-19%
United States	15.5	15.1	3%
Australia	3.0	3.1	-3%
Other **	2.3	1.7	35%
Total revenue	27.7	27.5	1%

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

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

Liquidity and Capital Resources

Financial Position and Cash Flow

To date, the Company has financed its research and development (R&D) and capital 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 their own internally generated cash flows, through the use of commercial banking facilities, and through capital leases with equipment vendors.

The Company was able to advance its key development platforms in both Food Safety and Human Health while maintaining a burn rate (cash used in operating activities) of approximately \$1.0 million per month during Fiscal 2008 and 2007. The burn rate has remained constant in spite of incurring increased research and development costs due to the Phase III clinical trial in refractory bladder cancer which started in November, 2006.

To address the Company's capital needs and to strengthen its financial position during Fiscal 2008 and Fiscal 2007, the Company completed the following transactions:

- On **December 8, 2006**, the Company sold its remaining 10% ownership position in Bioniche Pharma Holdings Limited for a total of \$6.7 million. From the proceeds, the Company partially repaid its convertible term

note in the amount of \$2.6 million in cash and \$0.2 million in shares for a total of \$2.8 million.

- On **December 22, 2006**, the Company announced the repayment of \$1.2 million of its debt with Laurus. The Company repaid \$0.6 million on the convertible term note and \$0.6 million on the revolving note. Both payments were made in common shares.
- On **January 11, 2007**, the Company announced the repayment, through the issuance of shares, of \$0.6 million on the revolving note with Laurus. It also announced that Laurus was converting \$0.6 million of the convertible term note into common shares.
- On **March 13, 2007**, the Company completed a unit offering. In total, the Company issued 14,583,333 units at a price of \$1.20 per unit for gross subscription proceeds of \$17,500,000. Each unit consisted of one common share and one-half of a common share purchase warrant.
- On **April 17, 2007**, the Company repaid \$0.6 million on the secured convertible term note with 670,943 common shares.
- On **June 6, 2007**, the Company announced that it converted \$3 million of Series 2 preferred shares to common shares. The total number of common shares issued was 2,388,323. This transaction did not generate any new cash for the Company.

- On **September 7, 2007**, the Company announced a \$2 million 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 expenditures.
- On **December 18, 2007**, the Company announced that it will receive a \$10 million repayable loan from the Ontario Ministry of Economic Development and Trade (MEDT)'s Advanced Manufacturing Investment Strategy (AMIS). This loan is in support of the Company's vaccine production facility scale-up in Belleville, Ontario, Canada, and is based on a percentage of eligible expenditures.
- On **December 20, 2007**, the Company announced it will receive a \$5 million repayable 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.
- On **December 21, 2007**, the Company announced an amendment to its revolving credit facility, resulting in a borrowing limit of US\$5.5 million.
- 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 \$5 million.
- On **March 27, 2008**, the Company announced the conversion of a portion of its revolving credit facility, issuing 2,671,900 common shares, resulting in additional borrowing capacity of \$1.8 million.
- On **June 25, 2008**, the Company amended a pre-existing \$7.6 million contribution agreement with the Industrial Technologies Office of Industry Canada that will support the scale-up of its vaccine production facility in Belleville, Ontario.
- On **September 9, 2008**, the Company announced the conversion of a portion of its revolving credit facility, resulting in the issuance of

approximately 4.6 million common shares and the availability of up to \$2.0 million in additional borrowing capacity.

At June 30, 2008, the Company had approximately \$4.4 million in cash and cash equivalents, in addition to another \$2.4 million in available borrowing capacity related to the revolving credit facility, for a total of \$6.8 million in cash and committed sources of funds, providing between four and five months of available cash flow for operations, based on current budgets and expectations. Prior to the occurrence of the subsequent event noted below, the Company expected to have used most of its working capital, cash and committed sources of funds before the end of the second quarter of Fiscal 2009.

Subsequent to June 30, 2008, on September 9, 2008, the Company elected to convert a portion of its revolving credit facility (see more under Consolidated Financial Statements, Note 20) to free up an approximately \$2 million in additional borrowing capacity. The Company expects that these additional funds will be sufficient to fund operations into the third quarter of Fiscal 2009. These additional committed funds were important to seek in order to maintain the current levels of activities, while pursuing or considering the other financing alternatives noted above. In addition, the Company may consider reconfiguring its three business segments if such a transaction would provide additional financial resources or increase shareholder value.

There is no assurance that any of these initiatives will be completed as currently planned. Given that there is significant uncertainty about the successful completion of these plans and the potential impact on the financial position, a going concern uncertainty disclosure has been included in note 1 to the June 30, 2008 Consolidated Financial Statements.

Contractual Obligations

(expressed in millions of Canadian dollars)

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
	\$	\$	\$	\$	\$
Long-Term Debt	2.2	0.5	1.1	0.3	0.3
Capital Lease Obligations	1.4	0.3	0.5	0.4	0.2
Operating Leases	0.8	0.4	0.3	0.1	
Purchase Obligations	5.6	5.6			
Other Long-Term Obligations	3.4	1.1	1.2	1.1	
Total Contractual Obligations	13.4	7.9	3.1	1.9	0.5

Revolving Credit Facility

On December 19, 2007, this three-year revolving credit facility was amended to increase the borrowing limit to US\$5.5 million from the previous maximum of US\$4.0 million. This facility matures on December 9, 2008. Amounts drawn are based on 90% of eligible accounts receivable and 35% of eligible North American inventory capped at US\$2.5 million plus US\$3.0 million. A fee of US\$1.0 million was charged to amend this facility and is payable in cash or in shares at the discretion of the Company at the date of maturity. This fee has been recorded as a reduction in the carrying value of the facility and is being amortized over the remaining life of the facility using the effective interest method. At June 30, 2008, US\$3.1 million [\$3,157,294] had been drawn on this facility, as compared to June 30, 2007, when US\$0.8 million [\$895,619] had been drawn.

Treasury Operations

The Company's treasury policy is to invest cash that is not required immediately into short-term instruments that are based on capital preservation. Such investments are primarily made in guaranteed investment certificates (GICs) and Canadian banker's acceptances (BAs), both of which are issued by Canadian chartered banks. There were no short-term investments as at June 30, 2008 [2007 — \$9,500,000].

Earnout from the Sale of Bioniche Pharma

The sale of Bioniche Pharma Group Ltd. to RoundTable Healthcare Partners included an entitlement for the Company to potentially receive contingent receipts associated with the future performance of the new Bioniche Pharma business. This could amount to a maximum of \$11.5 million over the five years. During the year ended June 30, 2008, the second year, Bioniche Pharma Group Ltd did not meet the criteria for making such a payment and, therefore, no income has been recorded or accrued in the Company's June 30, 2008 or 2007 consolidated financial statements.

Related Party Transactions

On June 3, 2005, the Company entered into a ten-year lease for a facility located at 271 Labrosse Avenue in Pointe-Claire, Quebec. The facility is leased to the Company from Renaissance (London) Investments Inc., a company owned and controlled by Graeme McRae, the Company's Chief Executive Officer and a Director. Under the terms of the lease, the Company had the option to purchase the facility by May 31, 2006 by assuming the balance of the loan outstanding. This option to purchase was extended effective May 31, 2006 for an additional two years and further extended for an additional one year to May 28, 2009. This transaction was recorded as a capital lease obligation as disclosed in Note 11 of the annual Consolidated Financial Statements. The facility consists of 14,000 square

feet and will be used for office and laboratory space, with the potential to add 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 demand for *Urocidin* for the North American and European clinical trials.

Proposed Transactions

As discussed elsewhere in this Management's Discussion and Analysis, the Company is considering and pursuing certain financing initiatives.

Off-Balance Sheet Arrangements

To date, the Company has not had any relationships with unconsolidated entities or financial partnerships, such as, entities referred to as structure 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 18, 2008 of 70,803,850. In addition, the Company has 10,903,861 outstanding warrants and 4,286,501 outstanding options, exchangeable for one common share upon exercise. Included in the outstanding warrant total are 1,027,308 compensation warrants issued to underwriters which, if exercised, would result in the issue of 1,027,308 shares and 513,654 warrants. The preferred shares Series II with conversion rights are exchangeable for a maximum of 6,521,677 common shares.

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 include these 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. We regularly review our inventories for obsolescence and valuation issues. Should selling prices and demand for our 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.

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 research and development tax credit receivables recorded as at June 30, 2008 is \$1.1 million [2007 – \$1.3 million].

Valuation Allowance on Future Tax Assets

The Company recorded a valuation allowance on all 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 directors, 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 our application of the fair value method include the determination of the volatility of our 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.

Results of product testing and market research indicate receptivity in the market for the technologies in development by the Company, which supports the carrying value of the long-lived assets and recorded goodwill. However, should regulatory approvals become protracted or costs to develop become prohibitive, future impairment testing may not support the recorded amounts and write-downs may be required. The ultimate success of the Company's key products is dependent upon obtaining regulatory approvals.

Change in Accounting Policies

The Canadian Institute of Chartered Accountants ["CICA"] recently released the following Handbook Sections: 3855, *Financial Instruments—Recognition and Measurement*; 1530, *Comprehensive Income*; 3251, *Equity*; 3865, *Hedges*; 3861, *Financial Instruments—Disclosure and Presentation*, and 1506, *Accounting Changes*. The Company adopted these sections on July 1, 2007. The impact of the adoption of these sections on the Company's consolidated financial statements is presented below.

Financial Instruments — Recognition and Measurement

Under Section 3855, all financial assets are classified as held for trading, held-to-maturity investments, loans and receivables or available-for-sale; all financial liabilities must be classified as held for trading or as other financial liabilities. All financial instruments are recorded initially on the consolidated balance sheet at their fair value. After initial recognition, financial instruments should be measured at their fair value, except for held-to-maturity investments, loans and receivables, and other liabilities, which should be measured at amortized cost using the effective interest method of amortization. Gains or losses resulting from changes in the fair values of financial assets classified as held for trading are included in income in the period in which they arise. Gains or losses resulting from unrealized changes in the fair values of available-for-sale financial assets are recognized in other comprehensive income until the financial instrument is derecognized and the cumulative gain or loss is then recognized in net income. An other than temporary loss in the value of an available-for-sale financial asset requires a write-down to its fair value through an impairment loss recognized in income.

The Company has classified its cash, cash equivalents and short-term investments as held for trading and its accounts receivable and other assets as loans and receivables. Following the transitional provisions of Section 3855, the estimated fair value of the Company's other assets required a reduction of \$52,007 to other assets, with a corresponding increase to the opening July 1, 2007 deficit. The adjusted value was and will be measured at amortized cost using the effective interest method of amortization.

Section 3855 also requires that embedded derivatives be separated from their host contract and accounted for as a derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. The Company has opted to apply this accounting treatment to all host contracts issued, acquired or substantially amended on or after January 1, 2003.

The Company determined that certain of its purchase commitments contain foreign currency embedded derivatives. Following the transitional provisions of Section 3855, the fair value of these embedded derivatives on July 1, 2007 resulted in the recognition of an asset of \$186,681 and a decrease to the opening July 1, 2007 deficit. The change in the fair value of the embedded foreign currency derivatives for the year ended June 30, 2008 resulted in an unrealized loss of \$126,988. The fair value of the embedded foreign currency derivatives was based on published foreign currency forward rates.

The revolving credit facility, accounts payable and accrued liabilities and long-term debt have been classified as other financial liabilities. Deferred financing fees in the amount of \$209,578 were reclassified from long-term assets and recorded as a reduction in the amount outstanding of the revolving credit facility in accordance with Section 3855.

The net transitional adjustment to the July 1, 2007 opening deficit was a credit of \$134,674.

Comprehensive Income (Loss) and Equity

Section 1530 establishes standards for reporting comprehensive income (loss) and as a result of the adoption of this new section, the cumulative amount, i.e. accumulated other comprehensive income (loss), is presented separately under shareholders' equity in the consolidated balance sheets and a reconciliation of the accumulated other comprehensive income (loss) as well as the comprehensive income (loss) for the period are presented in the interim consolidated statements of shareholders' equity. The Company has not recognized any other comprehensive income in its interim consolidated financial statements as at June 30, 2008 and for the year then ended.

Hedges

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedging is an activity designed to modify an entity's exposure to one or more risks. Hedge accounting modifies the basis for recognizing the gains, losses, revenue and expenses associated with a hedged item or a hedging item in an entity's income statement. It ensures that off-setting gains, losses, revenue and expenses are recognized in the same period. The adoption of this section had no impact on the Company's results of operations or financial position.

Recent Accounting Pronouncements

The CICA has issued the following new accounting Handbook Sections which are effective for the Company beginning on July 1, 2008:

Section 3031, *Inventories*, replaces the existing standard for inventories, Section 3030. The main features of the new section are as follows:

- Measurement of inventories at the lower of cost and net realizable value;
- Consistent use of either first-in, first-out or a weighted average cost formula to measure cost; and
- Reversal of previous write-downs to net realizable value when there is a subsequent increase to the value of inventories.

The Company is currently assessing the impact of the adoption of this new Section on its consolidated financial statements.

Section 3862, *Financial Instruments — Disclosure*, describes the required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 3863, *Financial Instruments — Presentation*, establishes standards for presentation of the financial instruments and non-financial derivatives. It carries forward the presentation related requirements of Section 3861, *Financial Instruments — Disclosure and Presentation*. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 1535, *Capital Disclosures*, establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure of the entity's objectives, policies and processes for managing capital, the quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and, if it has not complied, the consequences of such non-compliance. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 1400, *General Standards of Financial Statement Presentation*. This section has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 3064, *Goodwill and Intangible Assets*. Section 3064, 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. This standard is effective for the Company's interim and annual financial statements beginning on July 1, 2009. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards ["IFRS"] over a transition period expected to end in 2011. The Company is reviewing the transition to IFRS on its consolidated financial statements and has not yet determined the impact.

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).

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, 2008. 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.

Cash Flow and Financial Resources: The current burn rate of approximately \$1 million per month on average is expected to remain and grow during Fiscal 2009. In the near term, the Company will require cash to fund operations. The Company believes that it will be able to obtain long-term capital to support its corporate objectives. The Company is currently pursuing many opportunities to raise financial resources. However, it is impossible to guarantee the availability of additional financial resources or that these will be available under acceptable terms and conditions. If the Company doesn't obtain adequate funds or funds on reasonable terms, it may need to:

- Terminate or delay clinical trials of our product candidates;
- Delay the build out of manufacturing capabilities;
- Curtail significant product development programs;

- Sell or assign rights to our technologies, existing products, or product candidates; and/or
- Undertake a corporate reorganization.

The Company may be unable to obtain partnerships for one or more of its product candidates, which could curtail future development and negatively impact its share price.

The Company's product candidates require significant funding to reach regulatory approval upon positive clinical results. Such funding, in particular for *Urocidin* in bladder cancer, may be very difficult, or impossible to raise in the public markets without significant dilution. If such partnerships are not attainable, the development of these product candidates may be significantly delayed or stopped altogether. The announcement of such delay or discontinuation of development may have a negative impact on the Company's share price. In addition, the Company's strategy for the research, development and commercialization of its products requires entering into various arrangements with corporate collaborators, licensors, licensees and others, and the Company's commercial success is dependent upon these outside parties performing their respective contractual responsibilities. The amount and timing of resources that such third-parties will devote to these activities may not be within the Company's control. The Company cannot assure you that such parties will perform their obligations as expected. The Company also cannot assure you that its collaborators will devote adequate resources to its programs. In addition, the Company could become involved in disputes with its collaborators, which could result in a delay or termination of the related development programs or result in litigation. The Company intends to seek collaborative arrangements to develop and commercialize some of its products. The Company may not be able to negotiate collaborative arrangements on favorable terms, or at all, in the future, and there is no guarantee that current or future collaborative arrangements will be successful.

Clinical trials are long, expensive and uncertain processes and Health Canada or the FDA may ultimately not approve any of the Company's product candidates. The Company may never develop any further commercial drugs or other products that generate revenues.

The products under research have not yet received regulatory approval. The Company cannot market a pharmaceutical product in any jurisdiction until it has completed thorough pre-clinical testing and clinical trials in addition to that jurisdiction's extensive regulatory approval process. In general, significant research and development and clinical studies are required to demonstrate the safety and effectiveness of products before the Company

can submit any regulatory applications. Clinical trials are long, expensive and uncertain processes. Clinical trials may not be commenced or completed on schedule, and Health Canada or the FDA may not ultimately approve the Company's product candidates for commercial sale. Further, even if the results of the Company's pre-clinical studies or clinical trials are initially positive, it is possible that the Company will obtain different results in the later stages of drug development or that results seen in clinical trials will not continue with longer term treatment. Drugs in late stages of clinical development may fail to show the desired safety and efficacy traits despite having progressed through initial clinical testing. For example, positive results in early Phase I or Phase II clinical trials may not be repeated in larger Phase II or Phase III clinical trials. The results of the Company's upcoming Phase III clinical trial with *Urocidin* in bladder cancer may not meet the primary endpoint of the study despite promising preclinical and early stage clinical data.

In addition, unacceptable toxicities or adverse side effects may occur at any time in the course clinical trials or, if any products are successfully developed and approved for marketing, during commercial use of any approved products. The appearance of any such unacceptable toxicities or adverse side effects could interrupt, limit, delay or abort the development of any of the Company's product candidates or, if previously approved, necessitate their withdrawal from the market. Furthermore, disease resistance or other unforeseen factors may limit the effectiveness of the Company's potential products. The clinical trials of any of the Company's drug candidates could be unsuccessful, which would prevent it from advancing, commercializing or partnering the drug. The Company's failure to develop safe, commercially viable drugs would substantially impair its ability to generate revenues and sustain its operations and would materially harm its business and adversely affect its share price.

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

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

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

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

Foreign Currency Risks: The Company is exposed to foreign currency risks as a result of the sales of products, purchases of materials, and costs of manufacturing operations in currencies other than the Canadian dollar.

Volatility of Share Prices: Share prices are subject to change because of numerous different factors related to Company activity, including reports

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

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

Suppliers: The Company is dependant on certain third parties for the supply involved in the manufacturing of certain key products. Although it seeks to secure alternative suppliers, an interruption in the availability of certain raw material sources could have a material adverse effect on the Company's business and financial condition.

Other Risks and Uncertainties

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

- The Company expects to continue to experience losses. It is also difficult to estimate timing and future costs of its research and development programs.
- The Company is indirectly subject to price regulation in certain countries and this could affect its gross margin.
- The Company may not achieve its projected development goals in the time frames 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 drugs can be costly and require years of research and development activities.
- 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.

- 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 to protect or enforce 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, its clinical trials and product introductions may be delayed and its 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, or 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 stock 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.
- The Company has international operations that expose it to additional business risks.

Effectiveness of Disclosure Controls

The President and Chief Executive Officer and the Chief Financial Officer have reviewed the effectiveness of the Company's disclosure and internal controls and procedures as at June 30, 2008. Both officers have concluded that the Company's controls and procedures provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, was made known to them and reported as required, particularly during the period in which this report was being prepared. On an ongoing basis, management analyzes its controls and procedures to identify potential areas of improvement

Forward-Looking Statements

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

Other Information About the Company

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



Patrick Montpetit, CA, CF

Vice-President, Finance and Chief Financial Officer

September 18, 2008

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, 2008 and 2007 and the consolidated statements of loss, shareholders' equity 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, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Montreal, Canada

September 5, 2008

(except for Note 20, which is as of September 9, 2008)

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	2008	2007
	\$	\$
ASSETS [note 10]		
Current		
Cash and cash equivalents	4,399,065	1,523,597
Short-term investments [note 4]	—	9,500,000
Accounts receivable [note 5[a]]	6,443,299	5,495,836
Inventories [note 6]	4,738,765	5,480,167
Prepaid expenses and deposits	640,326	658,867
Foreign currency embedded derivatives [note 3]	59,693	—
	16,281,148	22,658,467
Long-term		
Property, plant and equipment [note 7]	9,718,157	9,557,359
Intangible assets [note 8]	7,688,698	8,545,215
Goodwill	456,155	456,155
Deferred financing fees [note 3]	—	209,578
Long-term accounts receivable [note 5[b]]	478,852	100,000
	34,623,010	41,526,774
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Revolving credit facility [note 9]	2,593,059	895,619
Accounts payable and accrued liabilities	8,341,398	6,399,382
Income and other taxes payable	104,592	283,845
Current portion of deferred government incentives [note 12]	—	541,282
Current portion of long-term debt and obligations under capital leases [notes 10 and 11]	706,505	123,769
	11,745,554	8,243,897
Long-term		
Long-term debt [note 10]	1,673,853	421,396
Obligations under capital leases [note 11]	1,176,237	764,933
Deferred government incentives [note 12]	3,606,926	2,986,572
	18,202,570	12,416,798
Shareholders' equity		
Share capital [note 13]	92,941,966	90,038,524
Special warrants [note 13]	2,174,008	2,174,008
Other paid-in capital [note 13]	6,056,115	5,528,059
Deficit	(84,751,649)	(68,630,615)
	16,420,440	29,109,976
	34,623,010	41,526,774

Commitments and contingencies [note 17]
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]

	Common shares	Preferred shares	Preferred shares	Special	Other	Deficit	Cumulative	Total
	#	\$	#	warrants	paid-in	\$	translation	\$
			— Series I		capital		adjustment	
			\$	\$	\$	\$	\$	\$
Balance, June 30, 2006	39,198,140	61,034,185	167	161,000	12,000,000	11,731,716	(53,869,621)	23,590,191
Net loss for the year	—	—	—	—	—	—	23,379	(14,737,615)
Issued under employee share ownership plan [note 13[c][v]]	544,777	508,997	—	—	—	—	—	508,997
Fair value of stock options vested [note 13[e]]	—	—	—	—	—	—	—	221,712
Directors' remuneration	109,998	77,000	—	—	—	—	—	77,000
Share bonus [note 13[c][iv]]	286,668	327,615	—	—	—	—	—	327,615
Shares issued on exercise of options	2,000	1,889	—	—	—	(89)	—	1,800
Conversion of Series II preferred shares [note 13[b]]	2,388,323	2,932,929	—	—	(3,000,000)	(2,932,929)	—	—
Term debt repayment made in shares [notes 10[a] and 13[c][iii]]	2,574,108	2,148,007	—	—	—	(162,931)	—	1,985,076
Warrants issued in connection with the convertible term note [note 10[a]]	—	—	—	—	—	93,023	—	93,023
Revolving debt principal payments made in shares [note 13[c][iii]]	2,004,745	1,602,963	—	—	—	—	—	1,602,963
Warrants issued to a consultant	—	—	—	—	—	—	—	39,300
Unit offering, net of issue costs [note 13[c][iii][iv]]	14,583,333	12,650,150	—	—	—	2,170,251	—	15,616,184
Shares issued on exercise of warrants, net of issue costs [note 13[c][iii][v]]	19,775	35,002	—	—	—	3,757	—	23,730
Balance, June 30, 2007	61,711,867	81,318,737	167	161,000	9,000,000	8,798,787	(68,630,615)	29,349,976
Less share purchase loan [note 13[c][v]]	—	(240,000)	—	—	—	—	—	(240,000)
	61,711,867	81,078,737	167	161,000	9,000,000	8,798,787	(68,630,615)	29,109,976

See accompanying notes

Bioniche Life Sciences Inc.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (CONTINUED)

[see going concern uncertainty — note 1]

	Common shares		Preferred shares — Series 1		Preferred shares — Series II		Special warrants	Other paid-in capital	Deficit	Total
	#	\$	#	\$	#	\$	\$	\$	\$	\$
Balance, June 30, 2007	61,711,867	81,318,737	167	161,000	9,000,000	8,798,787	2,174,008	5,528,059	(68,630,615)	29,349,976
Transition adjustment [note 3]	—	—	—	—	—	—	—	—	134,674	134,674
Net loss for the year	—	—	—	—	—	—	—	—	(16,255,708)	(16,255,708)
Issued under employee share ownership plan [note 13[c][v]]	808,291	638,500	—	—	—	—	—	—	—	638,500
Fair value of stock options vested [note 13[e]]	—	—	—	—	—	—	—	388,731	—	388,731
Directors' remuneration	73,560	76,502	—	—	—	—	—	—	—	76,502
Share bonus [note 13[c][iv]]	516,886	408,340	—	—	—	—	—	—	—	408,340
Warrants issued in connection with the revolving debt [note 10[a]]	—	—	—	—	—	—	—	112,000	—	112,000
Revolving debt principal payments made in shares [note 13[c][iii]]	2,671,900	1,780,100	—	—	—	—	—	—	—	1,780,100
Warrants issued to a consultant	—	—	—	—	—	—	—	27,325	—	27,325
Adjustment for conversion of fractional shares	6	—	—	—	—	—	—	—	—	—
Balance, June 30, 2008	65,782,510	84,222,179	167	161,000	9,000,000	8,798,787	2,174,008	6,056,115	(84,751,649)	16,660,440
Less share purchase loan [note 13[c][v]]	—	(240,000)	—	—	—	—	—	—	—	(240,000)
	65,782,510	83,982,179	167	161,000	9,000,000	8,798,787	2,174,008	6,056,115	(84,751,649)	16,420,440

See accompanying notes

Bioniche Life Sciences Inc.

**CONSOLIDATED STATEMENTS OF LOSS
AND COMPREHENSIVE LOSS***[see going concern uncertainty — note 1]*

Years ended June 30	2008 \$	2007 \$
REVENUE		
Sales	27,666,670	27,479,727
Cost of sales	11,837,457	12,179,266
Gross profit	15,829,213	15,300,461
EXPENSES		
Administration	6,710,565	7,239,106
Marketing and selling	6,993,390	6,106,225
Quality assurance	767,592	690,291
Interest on long-term debt	203,210	637,510
Other interest, net	(1,450)	75,049
Accreted interest on discounted receivables	(13,819)	—
Accreted interest on convertible term note	—	722,867
Amortization of property, plant and equipment	1,202,328	1,169,948
Amortization of intangible assets	856,517	856,518
Amortization of financial expenses	767,921	1,048,658
Foreign exchange loss (gain)	232,822	(55,375)
	17,719,076	18,490,797
Loss before research and development expenses and other items	(1,889,863)	(3,190,336)
Research and development expenses, gross	15,972,660	14,935,158
Less: government incentives, net <i>[note 12]</i>	(1,918,380)	(1,727,403)
Change in unrealized loss on foreign currency embedded derivatives <i>[note 3]</i>	126,988	—
Loss on sale of investment <i>[note 19]</i>	—	192,157
Gain on sale of rights to future royalty stream <i>[note 19]</i>	—	(2,127,587)
Loss before income taxes	(16,071,131)	(14,462,661)
Provision for income taxes <i>[note 16]</i>	184,577	298,333
Net loss and comprehensive loss for the year	(16,255,708)	(14,760,994)
Basic and fully diluted net loss per share	(0.26)	(0.32)
Weighted average number of common shares outstanding	63,104,876	45,827,257

See accompanying notes

Bioniche Life Sciences Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

[see going concern uncertainty — note 1]

Years ended June 30	2008 \$	2007 \$
OPERATING ACTIVITIES		
Net loss for the year	(16,255,708)	(14,760,994)
Add (deduct) non cash items:		
Amortization	2,826,766	3,075,124
Accreted interest on convertible term note	—	722,867
Change in unrealized loss on foreign currency embedded derivatives	126,988	—
Unrealized foreign exchange loss	(34,680)	38,208
Stock-based compensation	388,731	221,712
Warrants issued to consultants	27,325	39,300
Share bonus and shares issued to directors	544,507	962,759
Employee share ownership plan	684,556	523,559
Loss on sale of investment <i>[note 19]</i>	—	192,157
Gain on sale of right to future royalty stream and royalties recognized <i>[note 19]</i>	—	(2,618,306)
	(11,691,515)	(11,603,614)
Net change in non-cash working capital balances <i>[note 18]</i>	48,369	615,806
Cash used in operating activities	(11,643,146)	(10,987,808)
INVESTING ACTIVITIES		
Acquisition of short-term investments	—	(11,000,548)
Proceeds from maturity of short-term investments	9,500,000	1,500,548
Government incentives received on account of property, plant and equipment	4,641	30,224
Proceeds on disposal of property, plant and equipment	—	4,786
Proceeds from sale of investment <i>[note 19]</i>	—	3,196,200
Selling costs incurred for sale of investment and future royalty stream	—	(100,000)
Proceeds from sale of right to future royalty stream	—	3,652,800
Purchases of property, plant and equipment	(584,573)	(623,520)
Cash provided by (used in) investing activities	8,920,068	(3,339,510)
FINANCING ACTIVITIES		
Proceeds from units issued	—	17,500,000
Proceeds from over-allotment warrants issued	—	22,500
Proceeds from exercise of compensation warrants	—	23,730
Proceeds from exercise of stock options	—	1,800
Unit issue costs incurred	—	(1,906,316)
Proceeds from term note <i>[note 10]</i>	1,750,000	—
Payment of financing fees — debt	(88,010)	—
Proceeds from deferred government incentives	49,965	74,282
Proceeds from revolving credit facility	26,759,247	21,019,297
Repayment of revolving credit facility	(22,635,316)	(21,677,375)
Repayment of capital lease obligations	(217,232)	(198,799)
Repayment of senior and other long-term debt	(20,108)	(3,101,497)
Cash provided by financing activities	5,598,546	11,757,622
Net increase (decrease) in cash and cash equivalents during the year	2,875,468	(2,569,696)
Cash and cash equivalents, beginning of year	1,523,597	4,093,293
Cash and cash equivalents, end of year	4,399,065	1,523,597

See accompanying notes

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. 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 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, 2008, there was significant 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 had an accumulated deficit of \$84,751,649 as at June 30, 2008. The Company's committed cash obligations and expected level of expenses for the first half of fiscal 2009 exceed the committed sources of funds and funds available as at June 30, 2008. To date, the Company has financed its cash requirements primarily through issuances of shares, investment tax credits, sale of businesses or business units, products sales, royalties, government incentives, long-term debt and its revolving credit facility. The Company is currently pursuing several financing alternatives including completing a partnership deal to support its Phase III development program for *Urocidin*; issuing additional debt, preferred or common equity and finding strategic financing partners. The Company's ability to continue as a going concern is dependent on successful resolution of the above financing initiatives in the near term and its ability to continue to sell its existing products at positive margins, to obtain regulatory approvals and bring new products to market and achieve profitable operations in the future. The outcome of these matters is dependent upon many factors outside of the Company's control. If the Company is unable to obtain additional financing, management may be required to curtail the Company's 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 be unable to continue as a going concern. Such adjustments could be material.

2. Summary of Significant Accounting Policies

BASIS OF CONSOLIDATION

The consolidated financial statements reflect the consolidated financial position and results of operations of Bioniche Life Sciences Inc. and its 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. 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 [note 3]. As at June 30, 2008, cash and cash equivalents amounted to \$2,491,964 and \$1,907,101, respectively [2007 — \$1,523,597 cash only].

SHORT-TERM INVESTMENTS

Short-term investments are recorded at fair value, based on published price quotations.

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.

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 and assets acquired under capital leases 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
Leasehold improvements	straight-line basis over the lease term

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.

2. Summary of Significant Accounting Policies (continued)

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.

INTANGIBLE ASSETS

Intangible assets represent technology costs, patents and trademarks and the costs to acquire licenses.

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

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

If a license agreement is terminated or impaired, 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 other long-lived assets are regularly 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.

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.

REVENUE RECOGNITION

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.

Royalty revenue is recognized on an accrual basis in accordance with the contractual agreements.

Interest income is accrued as it is earned.

RESEARCH AND DEVELOPMENT COSTS

Research costs, which include a share of administrative expenses, are charged to income as incurred net of government incentives and tax credits earned. Development costs are charged against income in the period of the expenditure unless a development project meets the criteria under GAAP for deferral and amortization. At June 30, 2008 and 2007, no development costs have been deferred.

FOREIGN CURRENCY TRANSLATION

The Company's existing 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.

INCOME TAXES AND INVESTMENT TAX CREDITS

Future tax benefits and obligations 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, if any, are recognized only to the extent that, in the opinion of management, 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.

Investment tax credits, which are considered government incentives, arise as a result of incurring qualified scientific research and development expenditures and are recorded in that year as a reduction in the related expenditures when there is reasonable assurance of collection. Investment tax credits arising from capital expenditures are recorded as a reduction of the carrying value of the property, plant and equipment when there is reasonable assurance of collection.

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.

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 additional paid-in capital. Any consideration paid on the exercise of stock options is credited to share capital.

3. Changes in Accounting Policies

The Canadian Institute of Chartered Accountants ["CICA"] recently released the following Handbook Sections: 3855, *Financial Instruments — Recognition and Measurement*; 1530, *Comprehensive Income*; 3251, *Equity*; 3865, *Hedges*; 3861, *Financial Instruments — Disclosure and Presentation*, and 1506, *Accounting Changes*. The Company adopted these sections on July 1, 2007. The impact of the adoption of these sections on the Company's consolidated financial statements is presented below.

FINANCIAL INSTRUMENTS — RECOGNITION AND MEASUREMENT

Under Section 3855, all financial assets are classified as held for trading, held-to-maturity investments, loans and receivables or available-for-sale; all financial liabilities must be classified as held for trading or as other financial liabilities. All financial instruments are recorded initially on the consolidated balance sheet at their fair value. After initial recognition, financial instruments should be measured at their fair value, except for held-to-maturity investments, loans and receivables, and other liabilities, which should be measured at amortized cost using the effective interest method of amortization. Gains or losses resulting from changes in the fair values of financial assets classified as held for trading are included in income in the period in which they arise. Gains or losses resulting from unrealized changes in the fair values of available-for-sale financial assets are recognized in other comprehensive income until the financial instrument is derecognized and the cumulative gain or loss is then recognized in net income. An other than temporary loss in the value of an available-for-sale financial asset requires a write-down to its fair value through an impairment loss recognized in income.

The Company has classified its cash, cash equivalents and short-term investments as held for trading and its trade accounts receivable and long-term accounts receivable as loans and receivables. Following the transitional provisions of Section 3855, the estimated amortized cost of the Company's long-term accounts receivable required a reduction of \$52,007 to long-term accounts receivable, with a corresponding increase to the opening July 1, 2007 deficit. The adjusted value was and will be measured at amortized cost using the effective interest method of amortization.

Section 3855 also requires that embedded derivatives be separated from their host contract and accounted for as a derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. The Company has opted to apply this accounting treatment to all host contracts issued, acquired or substantially amended on or after January 1, 2003.

The Company determined that certain of its purchase commitments contain foreign currency embedded derivatives. Following the transitional provisions of Section 3855, the fair value of these embedded derivatives on July 1, 2007 resulted in the recognition of an asset of \$186,681 and a decrease to the opening July 1, 2007 deficit. The change in the fair value of the embedded foreign currency derivatives for the year ended June 30, 2008 resulted in an unrealized loss of \$126,988. The fair value of the embedded foreign currency derivatives was based on published foreign currency forward rates.

The revolving credit facility, accounts payable and accrued liabilities, excluding non-financial liabilities and long-term debt have been classified as other financial liabilities. Deferred financing fees in the amount of \$209,578 were reclassified from long-term assets and recorded as a reduction in the amount outstanding of the revolving credit facility in accordance with Section 3855.

The net transitional adjustment to the July 1, 2007 opening deficit was a credit of \$134,674.

COMPREHENSIVE INCOME (LOSS) AND EQUITY

Section 1530 establishes standards for reporting comprehensive income (loss) and as a result of the adoption of this new section, the cumulative amount, i.e. accumulated other comprehensive income (loss), is presented separately under shareholders' equity in the consolidated balance sheets and a reconciliation of the accumulated other comprehensive income (loss) as well as the comprehensive income (loss) for the period are presented in the interim consolidated statements of shareholders' equity. The Company has not recognized any other comprehensive income in its interim consolidated financial statements as at June 30, 2008 and for the year then ended.

HEDGES

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedging is an activity designed to modify an entity's exposure to one or more risks. Hedge accounting modifies the basis for recognizing the gains, losses, revenue and expenses associated with a hedged item or a hedging item in an entity's income statement. It ensures that off-setting gains, losses, revenue and expenses are recognized in the same period. The adoption of this section had no impact on the Company's results of operations or financial position.

RECENT ACCOUNTING PRONOUNCEMENTS

The CICA has issued the following new accounting Handbook Sections which are effective for the Company beginning on July 1, 2008:

Section 3031, *Inventories*, replaces the existing standard for inventories, Section 3030. The main features of the new section are as follows:

- Measurement of inventories at the lower of cost and net realizable value;
- Consistent use of either first-in, first-out or a weighted average cost formula to measure cost; and
- Reversal of previous write-downs to net realizable value when there is a subsequent increase to the value of inventories.

The Company is currently assessing the impact of the adoption of this new Section on its consolidated financial statements.

Section 3862, *Financial Instruments — Disclosure*, describes the required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 3863, *Financial Instruments — Presentation*, establishes standards for presentation of the financial instruments and non-financial derivatives. It carries forward the presentation related requirements of Section 3861, *Financial Instruments — Disclosure and Presentation*. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 1535, *Capital Disclosures*, establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure of the entity's objectives, policies and processes for managing capital, the quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and, if it has not complied, the consequences of such non-compliance. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

Section 1400, *General Standards of Financial Statement Presentation*. This section has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

3. Changes in Accounting Policies (continued)

Section 3064, *Goodwill and Intangible Assets*. Section 3064, 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. This standard is effective for the Company's interim and annual financial statements beginning on July 1, 2009. The Company is currently assessing the impact of the adoption of this new section on its consolidated financial statements.

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards ["IFRS"] over a transition period expected to end in 2011. The Company is reviewing the transition to IFRS on its consolidated financial statements and has not yet determined the impact.

4. Short-Term Investments

	2008 \$	2007 \$
Bankers' acceptances issued by a Canadian Chartered Bank earning interest at 4.27%, matured in August 2007	—	9,500,000

5. Accounts Receivable and Long-Term Accounts Receivable

[a] ACCOUNTS RECEIVABLE	2008 \$	2007 \$
Trade, net	4,435,985	3,698,032
Government incentives receivable	1,696,068	1,339,931
Other	311,246	457,873
	6,443,299	5,495,836

[b] LONG-TERM ACCOUNTS RECEIVABLE	2008 \$	2007 \$
Loans receivable	128,203	100,000
Government incentive holdbacks	495,116	—
	623,319	100,000
Less: Discount to reflect receivables at amortized cost [note 3]	(144,467)	—
	478,852	100,000

Loans receivable includes \$100,000 at June 30, 2008 and 2007 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 to over the next five years. Any outstanding balance at December 30, 2011 is payable in full. Loans receivable also includes \$28,203 at June 30, 2008 [2007 — \$33,203 was included in accounts receivable — other] outstanding from the chief executive officer and president who is also a director. The loan is interest free, payable in annual installments of \$5,000 per year. Both of these interest free loans have been discounted at 12% to reflect their amortized cost.

Government incentive holdbacks of 10% are being applied on two government programs [note 12]. The Industrial Technology Office ["ITO"] holdback is being discounted at 7.5% with an expected receipt date of September 30, 2011. The Rural Economic Development ["RED"] holdback is being discount at 5.69% with an expected receipt date of August 31, 2010 [note 12].

6. Inventories

	2008 \$	2007 \$
Raw materials	996,202	952,894
Work-in-process	1,060,445	1,508,182
Finished goods	2,682,118	3,019,091
	4,738,765	5,480,167

7. Property, Plant and Equipment

	Cost \$	Accumulated amortization \$	Net book value \$
2008			
Land	1,266,486	—	1,266,486
Buildings	4,616,541	1,195,492	3,421,049
Building under capital lease	1,255,265	147,198	1,108,067
Equipment	6,936,453	5,064,826	1,871,627
Equipment under capital lease	782,309	64,101	718,208
Computer equipment	2,618,205	1,721,406	896,799
Automobiles	257,934	204,275	53,659
Leasehold improvements	84,158	80,402	3,756
Construction in progress	378,506	—	378,506
	18,195,857	8,477,700	9,718,157
2007			
Land	1,266,486	—	1,266,486
Buildings	4,608,899	1,016,830	3,592,069
Building under capital lease	1,255,265	106,063	1,149,202
Equipment	6,650,758	4,623,109	2,027,649
Equipment under capital lease	53,944	24,786	29,158
Computer equipment	2,432,355	1,263,978	1,168,377
Automobiles	182,161	163,422	18,739
Leasehold improvements	84,158	77,187	6,971
Construction in progress	298,708	—	298,708
	16,832,734	7,275,375	9,557,359

The Company leases a building from an officer and director of the Company. This building is included under a capital lease and the corresponding capital lease obligation is included in obligations under capital leases [note 11]. The transaction was recorded at its exchange amount.

Amortization of assets under capital leases during the year ended June 30, 2008 amounted to \$106,119 [2007 – \$43,300].

At June 30, 2008 the Company had \$378,506 [2007 — \$298,708] in construction in progress relating to the scale up of a vaccine production facility in Belleville, Ontario. Amortization will not commence until the facility is substantially complete and ready for productive use.

8. Intangible Assets

	Cost \$	Accumulated amortization \$	Net carrying amount \$
2008			
Technology	11,974,171	4,951,296	7,022,875
Patents and trademarks	1,032,924	633,400	399,524
License agreements	611,516	345,217	266,299
	13,618,611	5,929,913	7,688,698
2007			
Technology	11,974,171	4,279,220	7,694,951
Patents and trademarks	1,032,924	491,862	541,062
License agreements	611,516	302,314	309,202
	13,618,611	5,073,396	8,545,215

9. 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 \$5,500,000 from the previous maximum of US \$4,000,000. Amounts drawn are based on 90% of eligible accounts receivable and 35% of eligible North American inventory, capped at US \$2,500,000 plus an additional US \$3,000,000. This Facility is open with the lender until December 9, 2008.

A fee of US \$1,000,000 was charged by the lender to amend the Facility and is payable in cash or in shares of the Company, at the discretion of the Company. This fee has been recorded as a reduction in the carrying value of the Facility and will be amortized over the remaining life of the Facility. As at June 30, 2008, the unamortized balance was \$424,750. Unamortized deferred financing fees related to the original note, in the amount of \$68,914, were reclassified from long-term assets and recorded as a reduction in the Facility, as discussed in note 3.

On March 27, 2008, the Company issued 2,671,900 common shares in lieu of cash principal repayments of the Facility, totaling \$1,780,100 [US \$1,750,000] and 200,000 five-year warrants valued at \$112,000 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. The value of the warrants has been recorded as a reduction of the carrying value of the Facility with a corresponding credit to other paid-in capital and will be amortized over the remaining life of the Facility using the effective interest rate method.

As at June 30, 2008, \$3,157,294 [June 30, 2007 — \$895,619] has been drawn on this Facility [\$2,593,059 net of unamortized financial expenses].

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, as a result of the repayment of the convertible term note [note 10[a]], the lender released the mortgage that it had held on the manufacturing facility in Belleville, Ontario.

10. Long-Term Debt

- [a] The Company had a three-year, US \$7,000,000 convertible term note, repayable in equal monthly instalments of cash or shares, making up 20% in the first two years and 60% in the third year, plus interest. The holder could convert the note, in whole or in part, into shares of common stock at any time upon one business day's prior written notice.

On December 9, 2006, the Company repaid US \$2,300,000 [\$2,625,450] of this convertible term note from the proceeds of the sale of its investment in Bioniche Pharma Holdings Limited and its right to a future *Suplasyn* royalty stream. In exchange for the release of the Lender's security in these assets, the Company issued five-year warrants to purchase 200,000 shares of common stock at \$1.00 per share. The fair value of these warrants, determined using the Black-Scholes option pricing model was \$93,023, and was recorded as a transaction cost and allocated pro rata between these transactions. The weighted average assumptions used to calculate this value were: risk-free interest of 5.20%; expected dividend yield of 0%; expected volatility of 44.89% and an expected life of 5 years.

During fiscal 2007, a total of US \$1,723,307 [\$1,985,076] of the convertible term note was repaid in common shares, a portion of which was initiated by the Lender, resulting in the issue of 2,574,108 common shares.

On April 17, 2007, the outstanding balance of this convertible note was paid and as a result of this prepayment, the Company fully amortized the related debt discount and unamortized financial expenses as well as recognizing the imputed interest on the convertible term note related to the equity portion of the debt and accrued withholding tax on the debt discount.

- [b] On February 7, 2008, the Company entered into a ten-year, \$5,000,000 commercial loan facility with the Business Development Bank of Canada ["BDC"]. This loan facility is collateralized by certain property, plant and equipment at the Company's Belleville, Ontario facility and is subject to certain financial and non-financial covenants. The loan bears interest, payable monthly, at the BDC floating rate of prime [June 30, 2008 — 6.75%] plus 2%, but the rate may be fixed at the Company's discretion. At June 30, 2008, the effective interest rate on the amount borrowed to date was 10.53%. Principal repayments commence September 1, 2008 with a payment of \$28,000 followed by monthly payments of \$44,000 until repaid. Disbursement in excess of \$1,750,000 will only be made if the Company makes certain qualifying expenditures. The proceeds will be used to finance the project to create an animal health and food safety vaccine manufacturing centre in Belleville, Ontario. Financing fees of \$87,338 have been recorded as a reduction of the carrying value of the loan and will be amortized over the life of this loan using the effective interest rate method.

As at June 30, 2008, \$1,750,000 has been drawn on this facility [\$424,000 current and \$1,240,882 long-term, net of unamortized financial expenses of \$85,118]. Commencing October 24, 2008, the Company must pay a monthly fee equal to 1.5% per annum on the undrawn portion of the loan facility. After January 24, 2009, the BDC may cancel the undrawn portion of the loan facility. The Company must provide a guaranteed irrevocable letter of credit to draw the last \$500,000 of the loan facility.

- [c] The Company has an AUS \$547,185 loan facility with ANZ Bank as of September 30, 2004 repayable over a 15 year term. Principal and interest payments of AUS \$6,000 [\$5,846] [2007 — AUS \$5,590; \$5,024] are payable monthly. The Company has provided a first charge over real estate and certain property in Australia with a carrying value of AUS \$716,288 [\$697,951] [2007 — AUS \$735,870; \$661,400] as collateral for this facility. The Company has AUS \$470,610 owing on this facility at June 30, 2008 [2007 — AUS \$492,558].

10. Long-Term Debt (continued)

	2008 \$	2007 \$
North American Operations		
[b] Business Development Bank of Canada, bearing interest payable monthly at the bank's floating rate of prime plus 2%, repayable in monthly principal payments of \$28,000 September 1, 2008 and \$44,000 monthly thereafter	1,750,000	—
Australian Operations		
[c] ANZ Bank, interest bearing at the bank's fluctuating mortgage index rate [8.94%; 2007 — 7.97%] plus 1.03%	458,562	442,711
Total senior debt	2,208,562	442,711
Less: unamortized financial expenses	85,118	—
Less: current portion	449,591	21,315
Total long-term debt	1,673,853	421,396

Principal repayments required after June 30, 2008 are as disclosed in note 11.

11. Obligations Under Capital Leases

	2008 \$	2007 \$
Capital leases		
Building, repayable in monthly instalments of \$16,667 from October 2008 until November 2015, including interest calculated at 10.1% [a]	1,433,334	1,583,334
Leases for equipment, repayable in variable monthly instalments until April 2013, at interest rates ranging from 4.75% to 8.00%	744,358	8,037
	2,177,692	1,591,371
Interest included in instalments	496,749	496,695
Advances netted against building lease	247,792	227,289
	1,433,151	867,387
Less: current portion	256,914	102,454
Total long-term obligations under capital leases	1,176,237	764,933

[a] In May 2005, the Company entered into a capital lease with an officer and director to lease a building for a ten-year period. Minimum lease payments are \$16,667 per month. Effective with April's lease payment, the Company has an agreement to reduce its monthly payments for a six-month period to the payment of interest only. The obligation is calculated as the net present value of the future lease payments calculated at 10.1%. In addition, the Company has made advances related to the leased property in the amount of \$20,503 [2007 — \$88,570] which have been offset against the obligations under this capital lease.

Principal repayments required after the 2008 fiscal year are as follows:

	Long-term debt \$	Obligations under capital leases \$	Total \$
2009	449,591	256,914	706,505
2010	556,262	276,589	832,851
2011	559,212	257,202	816,414
2012	304,471	251,211	555,682
2013	38,069	211,829	249,898
Thereafter	300,957	179,406	480,363
	2,208,562	1,433,151	3,641,713

12. Deferred Government Incentives and Government Assistance

Under the federal contribution program with Industry Canada's Industrial Technology Office ["ITO"] [formerly Technology Partnerships Canada], 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 cattle vaccine to a maximum of \$9,600,000 and \$7,600,000, respectively. At the Company's discretion, it can claim reimbursements at accelerated rates of 35% and 28% for *Urocidin* and the *E. coli* O157 cattle vaccine respectively to the maximum as noted above. As of January 2005, the accelerated rate for *Urocidin* was discontinued. Under the original agreements, if the Company did not reach certain expenditure levels for *Urocidin* and the *E. coli* O157 cattle vaccine by June 30, 2006 and March 31, 2007, respectively the portion of reimbursements received in excess of 18.3% and 21.6% of said expenditures becomes repayable to the ITO. These accelerated reimbursements have been recorded as deferred government incentives. Once the maximum eligible reimbursement under each program has been claimed, 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, 2008, accelerated reimbursements of \$620,354 associated with the *E. coli* O157 cattle vaccine project [\$541,282 shown as current in 2007] and \$2,986,572 associated with the *Urocidin* project [\$2,986,572 in 2007] are included in long-term liabilities.

In the event that either *Urocidin* or the *E. coli* O157 cattle vaccine become commercially available prior to the required expenditure levels being reached, any amounts received under the accelerated claims are not repayable. Total contributions claimed for both projects in fiscal 2008 were \$1,217,871 [\$1,303,473 in 2007] of which \$79,072 was included in deferred government incentives [\$94,847 in 2007] and \$84,826 [\$22,873 in 2007] has been netted against the related cost of property, plant and equipment. The remaining amount of \$1,053,973 [\$1,185,753 in fiscal 2007], has been presented as a reduction in research and development expense.

On September 23, 2005, the Company agreed to pay installments totaling \$465,000 plus interest at 3% to cure an event of default related to the structure of compensation paid to consultants used to secure the ITO agreement. The amount was accrued in fiscal 2005 and classified as a reduction in government incentives on the consolidated statements of loss. During the year ended June 30, 2007, \$92,019 plus interest was paid against this amount, settling it in full.

12. Deferred Government Incentives and Government Assistance (continued)

[i] UROCIDIN

During fiscal 2007, the Company reached an agreement with ITO to amend the existing agreement related to *Urocidin*. Under the terms of the new agreement, the maturity date for the project was extended to September 30, 2011; royalties potentially payable to ITO, commencing upon regulatory approval for commercialization, were increased to 6% from 1.9% of gross project revenues but the cap on total royalties potentially payable to ITO of \$11,278,115 remained unchanged. Warrants to purchase common shares provided for in the original agreement were replaced by annual cash payments of \$960,000 for five years, commencing no earlier than June 2010, 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.

In November 2007, the Company was informed by ITO that they would be exercising their option to withhold the last 20% of the funding for the *Urocidin* project until the project is completed, currently estimated to be September 30, 2011. On June 23, 2008, the holdback was reduced to 10%. As a result, the Company has discounted the amount withheld as at June 30, 2008 of \$455,106 to its fair value of \$357,466 using a discount rate of 7.5% and reclassified it to long-term accounts receivable [note 5[b]]. The discount has been reflected as a reduction in government incentives and will be amortized over the term that each claim amount is outstanding, using the effective interest rate method.

[ii] E. COLI O157 CATTLE VACCINE

During fiscal 2008, the Company reached an agreement with ITO to amend the existing agreement supporting the *E. coli* O157 cattle vaccine project. Under the terms of the new 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 \$500,000, increased to 2.5% from 1.49% with the cap on ITO's royalties increasing from \$6,763,000 to \$13,638,000, and the requirement to issue warrants to purchase common shares was removed. As a result of this amendment, liabilities related to this project have been reclassified to deferred government incentives at June 30, 2008.

[iii] GOVERNMENT ASSISTANCE

On September 7, 2007, the Company announced an agreement for a \$2,000,000 government grant from the Rural Economic Development Program ["RED"] for market development related to its *E.coli* O157 cattle vaccine. As at June 30, 2008, the Company has recognized \$434,773 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 \$40,010 to its fair value of \$35,234 using a discount rate of 5.69% and reclassified it to other assets [note 5[b]]. This discount will be amortized over the term that each claim amount is outstanding, using the effective interest rate method. The eligible amount less the discount has been netted against the related marketing expenses.

On December 18, 2007, the Company announced that it was eligible to receive up to \$10,000,000 in Ontario government financing in the form of a loan which will be interest-free until April 2013. This loan from the Ontario Ministry of Economic Development and Trade's 'Advance Manufacturing Investment Strategy' program will be based on eligible expenditures made by the Company since April 12, 2007, to scale up a vaccine production facility in Belleville, Ontario. Claims for funding related to eligible expenditures amounting to \$931,815 have been filed as at June 30, 2008. The long-term liability will be recognized when the cash is received and the difference between the fair value of this liability and the cash received will be recognized as government assistance.

On December 20, 2007, the Company announced that it was eligible to receive up to \$5,000,000 in federal government financing by the Department of Agriculture and Agri-Food (Canada) 'Agri-Opportunities' Program in the form of an interest-free loan based on eligible expenditures made by the Company since September 21, 2007, to scale up the aforementioned vaccine production facilities. The loan will be interest-free until fully repaid. Claims for funding related to eligible expenditures amounting to \$68,008 have been filed as at June 30, 2008. The long-term liability will be recognized when the cash is received and the difference between the fair value of this liability and the cash received will be recognized as government assistance.

In addition to the ITO program, the Company also receives government assistance under various federal and provincial tax incentive programs.

The government assistance recorded as a reduction of research and development expenses is as follows:

	2008 \$	2007 \$
ITO	1,053,973	1,185,753
Less: discount to fair value on portion held back	(96,443)	—
Investment tax credits	960,850	541,650
	1,918,380	1,727,403

The Company has available non-refundable investment tax credits of \$6,119,000 as at June 30, 2008 related to research and development expenditures which may be utilized to reduce federal income taxes payable in future years and expire as follows:

	\$
2009	16,000
2010	101,000
2011	301,000
2012	532,000
2013	594,000
2014	678,000
2015	1,000,000
2016–2026	1,018,000
2027	1,029,000
2028	850,000
	6,119,000

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

13. Share Capital and Other Paid-in 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:

	2008 \$	2007 \$
[a] Preferred shares — Series I	161,000	161,000
[b] Preferred shares — Series II	8,798,787	8,798,787
[c] Common shares	83,982,179	81,078,737
	92,941,966	90,038,524

[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, 2008, no dividends have been declared or paid [2007 — same].

[B] PREFERRED SHARES — SERIES II

On November 3, 2004 the Company issued 12,000,000 shares of Series II convertible preferred stock for gross consideration of \$12,000,000. 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. Issue costs for this private placement totaling \$268,284 were netted against the share capital of the Series II preferred shares.

On June 4, 2007, the holder converted 3,000,000 shares or 25% of their Series II convertible preferred stock at its accreted value for conversion purposes of \$3,463,068 to common shares at a conversion price of \$1.45. As a result, 2,388,323 common shares were issued.

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 [2007 — 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] Convertible term debt repayment in shares**

During the year ended June 30, 2007, US \$1,723,307 of the convertible term note was converted to 2,574,108 common shares with a conversion value of \$1,985,076. The portion of these conversions initiated by the Lender resulted in an allocation of the paid-in capital value of the conversion option of \$162,931 to common shares [note 10[a]].

[ii] Revolving debt principal payments made in shares

During the year ended June 30, 2008, the Company made Facility repayments of US \$1,750,000 through the issuance of 2,671,900 common shares and \$1,780,100 was added to share capital. [2007 — US \$1,392,453 repaid resulting in the issuance of 2,004,745 common shares and \$1,602,963 added to share capital].

[iii] Unit offering

On March 13, 2007, the Company completed a unit offering. In total, the Company issued 14,583,333 units at a price of \$1.20 per unit for gross subscription proceeds of \$17,500,000.

The following details the methodology and the assumptions used in these consolidated financial statements:

- I. Share Capital and Special Warrants: The Company issued 13,333,333 units at a price of \$1.20 per unit for gross subscription proceeds of \$16,000,000. Each unit was composed of one common share and one-half of one common share purchase warrant. Each one whole share purchase warrant entitles the holder to acquire one common share at a price of \$1.40 per common share until March 13, 2009. The value of one-half warrant was determined using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of 3.95%, an expected dividend yield of 0%, an expected volatility of 70% and an expected life of 2 years. The unit value has been allocated to share capital and warrants at \$1.01 and \$0.19 respectively based on the pro rata fair value of a common share and one-half of a purchase warrant.
- II. Over-Allotment Option: The over-allotment option was exercisable in whole or in part for 30 days from the closing date to purchase up to 2,000,000 common shares at \$1.17 per share and 1,000,000 warrants at a price of \$0.03 per warrant. The allocation of the unit value between common shares and the half a share warrant was as contractually agreed between the Company and the underwriters.

On March 13, 2007, 1,250,000 units were subscribed under the over-allotment option with an allocation of \$1.17 per share and \$0.03 per half warrant, for gross proceeds of \$1,500,000.

On April 12, 2007, the warrant component [allowing for the purchase of one-half of one common share] of the remaining 750,000 over-allotment units were subscribed for gross proceeds of \$22,500, less commission of 7%, resulting in net cash proceeds of \$20,925 and the issue of 26,250 compensation warrants valued at \$19,950 [see V below].
- III. Share Issue Costs: Expenses of the offering including 7% underwriters fee of \$1,226,575, the Black-Scholes value of compensation warrants as described below of \$795,783 and other professional fees and miscellaneous expenses of \$679,741 total \$2,702,099 and have been pro rated between the value of the shares and warrants issued, \$2,279,017 and \$423,082 respectively based on a ratio established by their respective values as described in I and II above.
- IV. The net proceeds of this transaction increased share capital by \$12,650,150 special warrants by \$2,170,251 and other paid-in capital by \$795,783.

13. Share Capital and Other Paid-in Capital (continued)

V. Compensation warrants: The underwriters received warrants equal to 7% of the units sold under the offering and 7% of the units, shares or warrants sold on exercise of the over-allotment option, resulting in the issue of 1,020,833 compensation warrants exercisable until March 13, 2009 [933,333 related to the initial offering, 87,500 related to the over-allotment unit option] and an additional 26,250 exercisable until April 12, 2009 related to the over-allotment option for the warrant component only. Each compensation warrant has an exercise price of \$1.20 and is composed of one common share and one-half of one common share purchase warrant exercisable at the price of \$1.40. The fair value of the compensation warrants, which includes the value of the half warrant, has been determined to be \$0.76 using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of 3.95%, expected dividend yield of 0%, expected volatility of 70% and expected life of two years. This value, totaling \$795,783, has been reflected as an expense of the offering and included in other paid-in capital.

On June 22, 2007, 19,775 compensation warrants were exercised for a cash consideration of \$23,730, resulting in the issue of 19,775 common shares valued at \$35,002; 9,887 special warrants valued at \$3,757 while other paid-in capital was reduced by \$15,029.

[iv] Share bonus

During the year ended June 30, 2008, the Company issued 516,886 common shares as a bonus, resulting in \$408,340 added to share capital [2007 — 286,668 common shares resulting in \$327,615 added to share capital].

The Company has also accrued a bonus for all eligible employees which is expected to be settled by issuing the Company's stock. As at June 30, 2008, management has estimated that 720,000 common shares with a fair value of approximately \$504,000 will be issued with respect to this bonus. This amount has been recorded in current liabilities and will be recorded in share capital when the common shares are issued.

[v] 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. Following the approval of shareholders at the 2007 annual general meeting, shares available under this plan were increased to 4,000,000. The Company's portion of this plan is recorded as stock-based compensation expense in the period incurred and totaled \$684,556 for the year ended June 30, 2008 [2007 — \$523,559]. At June 30, 2008, 86,600 common shares under this plan remain to be issued and an amount of \$60,620 is recorded in current liabilities until the common shares are issued [2007 — 53,706 common shares remained to be issued in the amount of \$55,854].

During 1995, the Company loaned \$240,000 to a former officer and director to purchase 40,000 common shares, on a non-interest bearing basis. There are no set terms of repayment. The shareholder has pledged the shares as collateral for the indebtedness. The fair value of the common shares at June 30, 2008 and 2007 were \$28,400 and \$41,600, respectively.

[D] WARRANTS AND SPECIAL WARRANTS

A summary of the Company's warrants outstanding as at June 30, 2008 is presented below:

Range of exercise prices	Warrants outstanding and exercisable		
	Number Outstanding #	Weighted average remaining contractual life [years] #	Weighted average exercise price \$
\$0.96 to \$2.10	10,903,861	1.0	1.37

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

	2008		2007	
	Warrants #	Weighted average exercise price \$	Warrants #	Weighted average exercise price \$
Outstanding, beginning of year	10,633,861	1.39	4,270,000	1.96
Granted to convertible term note holder [note 10[a]]	—	—	200,000	1.00
Granted to revolving credit Facility holder [note 10[a]]	200,000	0.77	—	—
Warrants issued to a consultant	70,000	1.04	80,000	1.04
Special warrants issued [note 13[c][iv]]	—	—	7,666,666	1.40
Compensation warrants	—	—	1,047,083	1.20
Compensation warrants exercised	—	—	(19,775)	1.20
Special warrants issued on exercise of compensation warrants	—	—	9,887	1.40
Expired	—	—	(2,620,000)	2.24
Outstanding, end of year	10,903,861	1.37	10,633,861	1.39

Compensation warrants are exercisable for one common share and one-half common share purchase warrant. If exercised, the outstanding compensation warrants at June 30, 2008 and 2007 would result in the issue of 1,027,308 shares and 513,654 warrants.

During the year ended June 30, 2007, the Company reached an agreement resulting in the cancellation of a commitment to issue warrants, with an estimated fair value of \$1,200,000 [note 12].

On June 7, 2008, the Company issued 70,000 fully vested warrants with an exercise price of \$1.04 to a consultant as previously approved at the November 8, 2007 Annual Shareholders' Meeting [2007 — 80,000]. The fair value of these warrants has been determined using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of 5.50% [2007 — 5.80%], an expected dividend yield of 0% [2007 — 0%], an expected volatility of 80% [2007 — 64%] and an expected life of 3.0 years [2007 — 3.0 years]. As the options were fully vested at the grant date, the entire estimated fair value of \$27,325 [2007 — \$39,300] has been recorded as an administration expense, with an offset to other paid-in capital.

13. Share Capital and Other Paid-in Capital (continued)**[E] STOCK OPTION PLAN**

The Company has a stock option plan for the benefit of employees, officers, directors and consultants, such that the maximum number of common shares available to be issued under the plan shall not exceed 6,000,000 as approved at the November 8, 2007 Annual Shareholders' Meeting [2007 — 3,459,829]. Under this plan, the Company has issued 3,456,501 [2007 — 3,031,501] stock options. In addition, outside of the stock option plan, 780,000 options ["Additional Options"] were granted in fiscal 2006 as an employment inducement and 50,000 were issued in fiscal 2004 related to an acquisition bringing total outstanding options to 4,286,501 at June 30, 2008 [2007 — 3,861,501].

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.

During the year ended June 30, 2007, 2,000 options were exercised at the exercise price of \$0.90 for proceeds of \$1,800, resulting in \$1,889 recorded in share capital, including \$89 reallocated to share capital from other paid-in capital.

A summary of the status of the Company's stock option plan as at June 30, 2008 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 \$
\$0.78 to \$1.15	1,843,000	3.2	0.90	614,000	0.89
\$1.58 to \$2.95	1,335,000	4.6	1.98	426,000	1.66
\$3.15 to \$3.50	309,001	6.5	3.18	109,001	3.15
\$4.00 to \$4.40	799,500	1.2	4.40	479,700	4.40
	4,286,501	3.5	2.06	1,628,701	2.28

The following table summarizes information about stock options outstanding at June 30:

	2008		2007	
	Options \$	Weighted average exercise price \$	Options \$	Weighted average exercise price \$
Outstanding, beginning of year	3,861,501	2.19	4,158,501	2.29
Granted	450,000	0.93	10,000	1.15
Expired	(25,000)	2.95	(305,000)	3.47
Exercised	—	—	(2,000)	0.90
Outstanding, end of year	4,286,501	2.06	3,861,501	2.19

[F] COMPENSATION EXPENSE

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

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

	2008	2007
Risk-free interest rate	5.78%	5.20%
Expected volatility	57.3%	55.2%
Expected option life	5.0 years	5.0 years
Dividend yield	0%	0%
Weighted-average fair value of options granted	\$0.49	\$0.61

14. Fair Value of Financial Instruments**FOREIGN CURRENCY RISK**

The significant balances in foreign currencies at June 30, 2008 and 2007 are as follows:

	U.S. dollars		Euros	
	2008 \$	2007 \$	2008 €	2007 €
Cash and cash equivalents	940,058	720,741	397,574	236,989
Accounts receivable	2,549,626	2,134,941	636,146	423,611
Revolving credit facility	(3,125,522)	(866,664)		—
Accounts payable and accrued liabilities	(2,522,494)	(1,509,151)	(460,792)	(95,488)
	(2,158,332)	479,867	572,928	565,112

	AUS dollars		NZL dollars	
	2008 \$	2007 \$	2008 \$	2007 \$
Cash and cash equivalents	133,844	173,187	—	—
Accounts receivable	481,113	418,004	—	4,071
Accounts payable and accrued liabilities	(331,072)	(539,542)	(62,692)	(303,959)
Long-term debt	(470,610)	(501,500)	—	—
	(186,725)	(449,851)	(62,692)	(299,888)

14. Fair Value of Financial Instruments (continued)

CREDIT RISK

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.

As at June 30, accounts receivable with respect to government incentives represented 10% and 6% of current assets in 2008 and 2007, respectively. At June 30, 2008, one customer comprised 10% of trade receivables [2007 — one customer, 12%].

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

FAIR VALUE

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. The carrying values of cash and cash equivalents, short-term investments, trade accounts receivable, the revolving credit Facility and accounts payable and accrued liabilities, excluding non-financial liabilities, are considered representative of their respective fair values due to the short-term maturity of these financial instruments. The fair value of embedded derivatives are based on published foreign currency forward rates. As at June 30, 2008, the carrying amount of the long-term debt with Business Development Bank is approximately equal to the fair value of the loan due to the variable rates of interest charged. Information related to the fair value estimates of other long-term liabilities are disclosed in note 10. The estimated fair value of obligations under capital leases and long-term accounts receivable, estimated by discounting expected cash flows at rates the Company could expect for similar instruments, are not significantly different than their carrying values.

15. Segmented Financial Information

The Company's three reportable segments in continuing operations, Animal Health, Human Health and Food Safety are strategic business units that offer different products and require different technology and marketing strategies. The Company's Human Health business segments historically included *Suplasyn* royalty revenue, the rights to which were sold in fiscal 2007 [note 19].

	2008				
	Human Health \$	Animal Health \$	Food Safety \$	Corporate \$	Total \$
Sales	—	27,649,020	17,650	—	27,666,670
Cost of sales	—	11,829,131	8,326	—	11,837,457
Expenses	—	8,078,269	1,733,448	4,659,830	14,471,547
EBITDA before research and development	—	7,741,620	(1,724,124)	(4,659,830)	1,357,666
Research and development expenses	11,464,430	1,939,977	2,568,253	—	15,972,660
Less: Government incentives	(1,698,349)	—	(220,031)	—	(1,918,380)
Net research and development expenses	9,766,081	1,939,977	2,348,222	—	14,054,280
Interest expense, net	—	94,558	—	93,383	187,941
Amortization of property, plant and equipment and intangible assets	1,118,345	764,525	60,231	115,744	2,058,845
Amortization of financial expenses	—	—	—	767,921	767,921
Foreign exchange loss	—	—	—	232,822	232,822
Change in unrealized loss on foreign currency embedded derivatives	—	—	—	126,988	126,988
Segment income (loss) before income taxes	(10,884,426)	4,942,560	(4,132,577)	(5,996,688)	(16,071,131)
Provision for income taxes	—	184,577	—	—	184,577
Segment assets	11,422,459	15,971,852	1,472,934	5,755,765	34,623,010
Goodwill	—	456,155	—	—	456,155
Purchases of property, plant and equipment	548,824	442,646	16,179	355,474	1,363,123

15. Segmented Financial Information (continued)

	2007				
	Human Health \$	Animal Health \$	Food Safety \$	Corporate \$	Total \$
Sales	490,720	26,989,007	—	—	27,479,727
Cost of sales	—	12,179,266	—	—	12,179,266
Expenses	392,680	8,048,845	1,284,791	4,309,306	14,035,622
EBITDA before research and development	98,040	6,760,896	(1,284,791)	(4,309,306)	1,264,839
Research and development expenses	10,345,274	1,912,080	2,677,804	—	14,935,158
Less: Government incentives	(1,430,177)	—	(297,226)	—	(1,727,403)
Net research and development expenses	8,915,097	1,912,080	2,380,578	—	13,207,755
Interest expense, net	—	80,096	—	1,355,330	1,435,426
Amortization of property, plant and equipment and intangible assets	1,070,335	804,350	68,775	83,006	2,026,466
Amortization of financial expenses	—	—	—	1,048,658	1,048,658
Foreign exchange loss	—	—	—	(55,375)	(55,375)
Gain on sale of rights to future royalty stream	—	—	—	(2,127,587)	(2,127,587)
Loss of sale of investment	—	—	—	192,157	192,157
Segment income (loss) before income taxes	(9,887,392)	3,964,370	(3,734,144)	(4,805,495)	(14,462,661)
Provision for income taxes	—	298,333	—	—	298,333
Segment assets	11,728,175	16,252,393	1,218,407	12,327,799	41,526,774
Goodwill	—	456,155	—	—	456,155
Purchases of property, plant and equipment	29,627	150,601	413,326	29,966	623,520

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.

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

	2008 \$	2007 \$
Revenue		
Canada	5,634,416	6,016,275
Europe *	1,276,964	1,645,433
United States	15,500,076	15,053,359
Australia	2,954,607	3,060,867
Other **	2,300,607	1,703,793
Total revenue	27,666,670	27,479,727

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

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

	2008 \$	2007 \$
Total assets		
Canada	26,382,719	33,684,147
Ireland	1,720,602	937,568
United States	4,085,995	4,150,378
Australia	2,433,694	2,754,681
Total assets	34,623,010	41,526,774
Property, plant and equipment and goodwill		
Canada	9,165,396	8,962,246
Other	1,008,916	1,051,268
Total property, plant and equipment and goodwill	10,174,312	10,013,514

16. Income Taxes

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

	2008 \$	2007 \$
Loss before income taxes	(16,071,131)	(14,462,661)
Basic income tax rate	34.34%	34.88%
Computed income tax recovery (expenses)	5,518,827	5,044,576
Effect on income tax rate resulting from:		
Foreign jurisdictions rate differential	(201,551)	(192,000)
Unrecorded potential tax benefits of current period losses	(4,889,051)	(4,926,038)
Benefit of losses not previously recognized	—	706,000
Accounting charges not deductible for tax purposes	(612,802)	(930,871)
	(184,577)	(298,333)

16. Income Taxes (continued)

As at June 30, 2008, the Company has non-capital losses of approximately \$29,740,000 for Canadian federal and Ontario purposes and \$24,490,000 for Quebec purposes that are available to offset future taxable income. These losses expire as follows:

	Federal and Ontario \$	Quebec \$
2009	730,000	715,000
2010	4,505,000	4,165,000
2014	4,085,000	3,660,000
2015	4,960,000	4,445,000
2026	3,765,000	2,045,000
2027	7,205,000	6,480,000
2028	4,490,000	2,980,000
	\$29,740,000	\$24,490,000

The Company has Scientific Research and Experimental Development ["SRED"] expenditures of approximately \$34,500,000 [2007 — \$30,000,000] for federal and Ontario income tax purposes and \$43,000,000 [2007 — \$34,000,000] for Quebec 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.

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:

	2008 \$	2007 \$
Future tax assets		
Net operating loss carryforwards	8,550,000	8,340,000
Tax basis of capital assets and intangibles in excess of carrying values	1,981,000	1,596,000
Research and development expenditures	10,069,000	9,855,000
Deferred revenue	1,034,000	—
Financing fees	672,000	910,000
Total gross future tax assets	22,306,000	20,701,000
Less: valuation allowance	(20,293,000)	(18,126,000)
Net future tax assets	2,013,000	2,575,000
Future tax liabilities		
Investment tax credit		31,000
Carrying value of intangibles in excess of tax basis	2,013,000	2,544,000
Total future tax liabilities	2,013,000	2,575,000
Net future tax liabilities	—	—

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 income taxes are as follows:

	2008 \$	2007 \$
Current tax expense	184,577	1,004,333
Future income tax benefit resulting from recognition of loss carryforwards	—	(706,000)
	184,577	298,333

17. 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:

	\$
2009	425,355
2010	155,095
2011	81,916
2012	71,585
2013	36,164
	770,115

In addition to the royalties described in note 12, 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.

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 \$400,000 per year payable semi-annually over five years. The Company has expensed \$378,555 in research and development related to this funding during the year ended June 30, 2008, [2007 — \$398,030].

[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.

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.

18. Consolidated Statements of Cash Flows

	2008 \$	2007 \$
Net change in non-cash working capital balances:		
Accounts receivable	(1,349,214)	(782,129)
Inventories	741,402	691,286
Prepaid expenses and deposits	18,541	145,603
Accounts payable and accrued liabilities	816,893	772,082
Income and other taxes payable	(179,253)	(211,036)
	48,369	615,806

Included in accounts payable and accrued liabilities are liabilities in the amount of \$1,637,209 which will be settled through the issuance of shares [2007 — \$572,707].

Supplemental cash flow information:

	2008 \$	2007 \$
Cash paid for		
Income taxes	70,219	408,606
Interest	127,236	948,544
	197,455	1,357,150

19. Loss on Sale of Investment and Gain on Sale of Future Royalty Stream**[A] SALE OF INVESTMENT**

On December 6, 2006, the Company sold its 10% investment in Bioniche Pharma Holdings Limited ["Pharma"] of \$3,298,279, for US \$2,800,000 [\$3,196,200]. The Company retains its entitlement to receive contingent receipts associated with the future performance of the new Pharma business. No amounts in respect of the earnout have been recorded in the consolidated financial statements. The sale, net of selling costs of \$46,667 and the fair value of warrants of \$43,411 issued to the senior debt holder to release its collateral resulted in a loss of \$192,157.

[B] SALE OF RIGHTS TO FUTURE ROYALTY STREAM

The December 6, 2006 sale also included the sale of the Company's right to future *Suplasyn* royalty payments for US \$3,200,000 [\$3,652,800]. The gain of \$2,127,587 recorded as a result of this sale is net of previously accrued royalties of \$1,422,268 of which \$490,719 had been recorded during the year ended June 30, 2007. Transaction costs, which include the fair value of warrants of \$49,612 issued to the senior debt holder to release its collateral and other fees of \$53,333, amounted to \$102,945.

20. Subsequent Event

On September 9, 2008, the Company issued 4,565,049 common shares in lieu of cash principal repayments of the revolving credit Facility, totalling \$1,966,934 [US \$1,850,000] and 211,429 five-year warrants valued at \$65,794 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.

21. Comparative Consolidated Financial Statements

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2008 consolidated financial statements.

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

President, BioMedEx Inc.

LORNE BABIUK*, B.S.A., M.Sc., Ph.D., D.Sc.

Vice-President (Research), University of Alberta

MICHEL BAZINET*, M.D. ^{(2) (3) (4) (6)}

Chairman and CEO, Replicor Inc.

MARGARET CUNNINGHAM PH.D. ^{(1) (2) (6)}Associate Professor, School of Business,
Queen's University**PIERRE-YVES DESBIENS, C.A., MBA** ^{(1) (2) (6)}

Vice-President, Finance, PureCell Technologies Inc.

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

Partner, King & Spalding LLP

LYLE VANCLIEF ^{(2) (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* Will not be standing for re-election at the
2008 Annual Meeting of Shareholders**EXECUTIVE MANAGEMENT****Graeme McRae**

Chairman, President and CEO

Cindy BenningVice-President, Operations, Quality and
Regulatory Affairs**François Charette, M.D., MBA**

Senior Vice-President and Chief Medical Officer

Rick Culbert

President, Bioniche Food Safety

Leslie DunlopVice-President, Corporate Counsel
Secretary of the Board of Directors**Mohamed Elrafih**

Vice-President Manufacturing Operations

Andrew GrantDivisional President, Bioniche Animal
Health Export Sales, Europe & Australia**Cameron Groome**Executive Vice-President, Corporate &
Strategic Development**Bruce McLeod**

Vice-President, Human Resources

Patrick Montpetit, C.A., C.F.Vice-President, Finance and
Chief Financial Officer**Jim Phillips**

President, Bioniche Animal Health (global)

Nigel C. Phillips, Ph.D.

Senior Vice-President and Chief Scientific Officer

Dragan Rogan, Ph.D.Vice-President, Research & Development
(Animal Health)**Jennifer Shea**Vice-President, Communications,
Investor & Government Relations**Dr. Gary Weber**

President, Bioniche Food Safety (U.S.)

ANNUAL MEETING:The Annual Meeting of Shareholders
will be held onThursday, November 6, 2008, 4:00 p.m.
Courtyard by Marriott Downtown Toronto
475 Yonge Street
Toronto, Ontario, Canada**STOCK LISTING:****Toronto Stock Exchange**

Symbol: BNC

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Toronto, Ontario, Canada

AUDITORS:**Ernst & Young, LLP**

Montreal, Quebec, Canada

TRANSFER AGENT:**CIBC Mellon Trust Company**

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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 our Internet website at www.Bioniche.com, through our Corporate Communications & Investor 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

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