

November 14, 2006

## MESSAGE TO SHAREHOLDERS

During the last quarter, we had the opportunity to highlight our lead HIV protease inhibitor PPL-100 at three of the most prestigious conferences in the fields of HIV and infectious diseases: the 15<sup>th</sup> International HIV Drug Resistance Workshop (June 13-18, Sitges, Spain), the XVI International AIDS Conference (August 13-18, Toronto), and the 46<sup>th</sup> ICAAC (Interscience Conference on Antimicrobial Agents and Chemotherapy) held in San Francisco September 27-30. This positively increased the awareness of PPL-100, and its potential to be a best in class treatment for HIV/AIDS, amongst the scientific community and the industry. Subsequently, we were pleased to announce the conclusion of an exclusive worldwide licensing agreement for PPL-100 and its related compounds in return for milestones payments of up to US\$ 232 million, including a US\$ 17 million upfront payment and a royalty on future sales, with Merck & Co., Inc., a pharmaceutical world leader in the fight against HIV/AIDS for two decades. This is a key milestone attained for Ambrilia, since it allows the Company to be much stronger financially and therefore to be able to invest in the development of its pipeline.

Also this quarter, we were happy to announce positive results of a pivotal human pharmacokinetic study of Ambrilia's new prolonged release formulation of Octreotide. We now move forward as planned with the development program of our lead specialty generic for the treatment of acromegaly and prepare to initiate small clinical studies in acromegaly patients before the end of the year.

On the corporate front, we welcomed a new member to Ambrilia's Board of Directors, Luc Tanguay, Senior Executive Vice-President and Chief Financial Officer of Theratechnologies Inc., a seasoned manager with a strong knowledge of the biotechnology industry. Finally, on October 19, we put into effect a share consolidation, as approved by Ambrilia's shareholders last February, with a ratio of one for ten common shares.

## INFECTIOUS DISEASES UPDATE

### **PPL-100, a promising HIV protease inhibitor: Exclusive worldwide rights granted to Merck & Co. in return for milestone payments that could total up to US\$ 232 million**

On October 12, Ambrilia granted Merck the exclusive worldwide rights to its lead compound against HIV/AIDS, PPL-100, and to its Protease Inhibitor (PI) Program. In return Ambrilia received an upfront licensing fee of US\$ 17 million on signing and is now eligible for cash payments totaling up to US\$ 215 million upon successful completion of development, clinical, regulatory and sales milestones, and royalties on all future product sales. The first of the milestone payments (US\$ 3 million) will be based on the successful completion of a Phase I repeat dose pharmacokinetic study (Phase Ib), the results of which are expected in late November. Merck will then assume all subsequent development costs related to PPL-100.

In addition, Ambrilia is now positioned to receive significant additional milestone-based cash payments and royalties on the future development and commercialization of each back-up compound and/or related compounds developed by Merck and which fall within the scope of Ambrilia's HIV Protease Inhibitor Program.

This was without a doubt not only a very significant milestone for Ambrilia but a further validation of the potential of PPL-100 as a best in class HIV protease inhibitor with many advantages; excellent safety and tolerability, favorable cross-resistance profile, high genetic barrier and finally a possible once-a-day dosage without ritonavir (another PI used as a boosting agent). Today, there is a pressing need for better tolerated and more convenient and effective PIs. PPL-100 could bring significant revenues based on its competitive advantages in a global HIV/AIDS market which is estimated to reach US\$ 9 billion\* in 2011 (projected time of launch of PPL-100).

\* Decision Resource – 2004 HIV Infectious Diseases Study #68, Frost & Sullivan 2004, Strategic Analysis World HIV Market, 2006 DataMonitor – Pipeline insight HIV

## **ONCOLOGY UPDATE**

### **Octreotide, an added-value specialty generic: Positive pivotal PK results**

Octreotide, Ambrilia's added-value specialty generic for the treatment of acromegaly is an easily reconstituted, prolonged-release equivalent of Novartis's Sandostatin® LAR (long-acting release). Just recently, the Company announced the positive results of a pivotal PK study designed to evaluate the absorption, distribution and metabolism of Octreotide in comparison to Sandostatin® LAR in human subjects.

The data generated in a controlled study in healthy volunteers performed in a FDA (U.S. Food and Drug Administration) approved clinical centre showed that Ambrilia's formulation has a bioavailability superior to that of Sandostatin LAR® at the same dose. Sandostatin LAR®'s data sheet recommends injections of the product every four weeks. Ambrilia's product bioavailability will allow for longer time intervals between injections, from 13 per year to 8-9 per year. This could improve patient compliance, and reduce the discomfort and costs associated with injections. In addition, the study supports the better stability and ease of use of Ambrilia's patented formulation, as compared to Sandostatin LAR®.

This PK study will be part of the international file designed to obtain registration of Ambrilia's Octreotide worldwide. Ambrilia is currently setting up small clinical studies of its formulation in acromegaly patients, as scheduled in the development plan of the product. Completion of these studies is expected around mid 2007. Filing for approval in Europe and then North America by Ambrilia's licensees will follow shortly thereafter.

Ambrilia will manufacture the product at its cGMP (Good Manufacturing Practices) facility in Montreal, Canada and supply the finished product to its commercial partners for sale in the U.S., E.U. and some other countries at a contractually fixed price.

### **Goserelin, a potential first-to-market generic: In house formulation optimization ongoing**

Goserelin, Ambrilia's specialty generic for the treatment of hormone-sensitive prostate cancer, is the potential first-to-market equivalent of Astra Zeneca's Zoladex®. Latest research and development activities allowed Ambrilia to manufacture four different formulations of the final product and complete the animal kinetic assays. Those assays confirmed the 3-month sustained release of the product. In house optimization of the formulation is now ongoing. The human pharmacokinetic, single dose study is expected to be initiated in 2007, followed by a Canadian and European multi-center study in prostate cancer patients anticipated to begin in the second half of 2007. If there are no unexpected delays in this timeline, regulatory filing in Europe should be completed by the first half of 2008.

### **PCK3145, a non-toxic anti-cancer peptide: U.S. pilot study high dose results expected in H1/2007**

PCK3145, Ambrilia's therapeutic peptide with signal transduction mediated effects on tumor metastasis indicated for hormone-resistant prostate cancer, is currently undergoing clinical evaluation at the Memorial Sloan Kettering Institute in New York. An amendment to the U.S. pilot study protocol investigating a higher dose and an uninterrupted prolonged administration of four months is now ongoing. It is anticipated that a higher dose may potentially give added clinical benefit to patients with late stage disease as well as show a potential early indication of efficacy. Results of this study are expected to be available in the first half of 2007.

Furthermore, the Company continues to actively pursue discussions with potential co-development/licensing partners for PCK3145.

### **PSP94 immunoassay: Prognostic value confirmed by an extensive study conducted by Virginia Urology**

On November 2, Ambrilia announced the findings of an extensive study on 185 patients conducted in collaboration with Dr. Dharam Ramnani, Laboratory Director at the Virginia Urology Pathology Laboratory, Richmond, Virginia, with its PSP94 (Prostate Secretory Protein of 94 amino acids) immunoassay for the diagnosis and prognosis of prostate cancer, suggesting its reliability as a prognostic test for relapse following radical prostatectomy (surgical operation to remove the prostate gland and surrounding tissues) for prostate cancer. Findings of this study were published in the October 15th issue of *Clinical Cancer Research* (Vol. 12, pp. 6018 - 6022).

Ambrilia was pleased to have the prognostic value of PSP94 confirmed, since a need exists for reliable markers to complement the actual standard of prostate specific antigen (PSA) testing and allow for better prostate cancer management. The PSP94 assay has the potential to be a very advantageous and reliable test in predicting prostate cancer recurrence in patients who have undergone surgery (radical prostatectomy). As well, Ambrilia had previously shown the diagnostic value of its PSP94 immunoassay as a reliable marker for seeking out patients with aggressive prostate cancer which can be fatal (as previously announced on December 2, 2005).

Ambrilia is in discussions with diagnostic companies for the co-development and marketing of PSP94 as a global diagnostic/prognostic marker for prostate cancer. At the same time, the Company is preparing a European submission, with the aim of obtaining a CE Mark for PSP94 within the next few months.

In conclusion, Ambrilia has attained a key milestone with the licensing of its PPL-100 and HIV Protease Inhibitor Program to Merck & Co., Inc. I feel confident that Merck will advance successfully the development of PPL-100, and potentially other related compounds, which could represent a significant progress for patients and physicians in the fight against HIV/AIDS. This major deal solidifies financially the Company, without dilution, and will allow us to invest cash resources in the development of our portfolio. For Ambrilia, other potential opportunities such as Octreotide and PCK3145 are continuing to advance and may be realized in the near future. I believe that investing in these and other selected development programs today is crucial to Ambrilia's sustainable, long-term growth.

Sincerely,

A handwritten signature in black ink, appearing to read 'H. Mäder', is written over a thin vertical red line.

Hans J. Mäder  
President and Chief Executive Officer

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

The following information should be read in conjunction with Ambrilia Biopharma Inc. ("Ambrilia" or the "Company") unaudited consolidated financial statements and related notes included herein, together with our audited consolidated financial statements for the year ended December 31, 2005 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts shown are stated in Canadian dollars. This review was prepared by management from information available to October 31, 2006. Additional information relating to the Company, including the Company's Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

On October 12, 2006, the Company announced that it had entered into an exclusive licensing agreement granting the worldwide rights to its HIV/AIDS protease inhibitor program to an affiliate of Merck & Co., Inc. Under the terms of the agreement, the Company received an upfront licensing fee of US\$17 million and is eligible to receive milestone payments totaling up to US\$215 million and royalties on all future product sales.

On October 13, 2006, the Company effected a share consolidation on the basis of one new common share for each ten common shares held. The consolidation affects all of the Company's outstanding common shares and convertible securities, such as options, warrants, preferred shares and convertible debentures. All applicable numbers of shares and other securities in this report, as well as per-share data, have been adjusted to reflect this change on a retrospective basis.

On March 1, 2006 the Company acquired 87.117% of the outstanding shares of Cellpep S.A., a French private biotechnology company in exchange for 10,162,762 common shares of Ambrilia with a fair value of \$32,520,883. Acquisition expenses amounted to \$1,979,031. In a concurrent transaction, a total of \$18,095,904, before cash expenses of \$1,231,123, was obtained from a private placement of 7,867,775 common shares of Ambrilia at \$2.30 per share, with warrants to purchase an additional 7,867,775 common shares at \$3.50 per share to March 1, 2011. The underwriters also received broker compensation warrants to purchase up to 370,143 common shares at \$2.30, with warrants to purchase an additional 370,143 common shares at \$3.50 per share to March 1, 2011. On April 21, 2006, Cellpep S.A. changed its name to Ambrilia Biopharma France S.A. ("Ambrilia France").

### **FORWARD LOOKING STATEMENTS**

Some of the statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements. These statements relate to future events or to Ambrilia's future financial performance and involve known and unknown risks, uncertainties and other factors that may cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

### **OVERVIEW**

Ambrilia Biopharma Inc. (TSX:AMB) is a biopharmaceutical company developing innovative therapeutics in the fields of oncology and infectious diseases. Ambrilia's strategy is to acquire and advance drug candidates through early to mid-stage clinical trials and then pursue co-development or out-licensing options with pharmaceutical companies. At the same time, with the acquisition of Ambrilia France, the Company has changed its business model to accelerate its access to cash by developing and manufacturing high-value specialty generics in order to provide the Company with an early and sustainable cash flow.

Ambrilia's product portfolio includes mid to early-stage products and two specialty generics, the first of which is late-stage and value-added. Ambrilia's first generic product is Octreotide, an easily reconstituted long-acting release equivalent to Novartis's Sandostatin®, used for the treatment of a rare disease called acromegaly caused by a tumor of the pituitary gland, and for certain rare digestive tumors. The second product is Goserelin, a potential first-to-market generic alternative to Astra Zeneca's Zoladex®, used primarily for the treatment of

hormone-sensitive prostate cancer. Ambrilia's mid to early-stage products include: PPL-100, a promising protease inhibitor for the treatment of HIV/AIDS currently in Phase I clinical trials and for which an exclusive worldwide licensing agreement was signed with an affiliate of Merck & Co., Inc. in October 2006; PCK3145, a therapeutic anti-cancer peptide with signal transduction mediated effects on tumor metastasis and angiogenesis; TVT-Dox, a novel anti-cancer technology targeting tumor vasculature for which an IND filing for the treatment of solid tumors is expected in 2008; an integrase inhibitor program for the treatment of HIV/AIDS and SPC3, a fusion inhibitor for the treatment of HIV/AIDS, both of which are at the preclinical stage. Ambrilia's diagnostic products include PSP94 (Prostate Secretory Protein of 94 amino acids) immunoassay for the diagnosis and prognosis of prostate cancer.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. The reported amounts and note disclosures in the consolidated financial statements are determined using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. Actual results, however, may differ from the estimates used in the consolidated financial statements and such differences could be material. Details of our critical accounting estimates were reported in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2005 and these continue to apply for the nine months ended September 30, 2006.

### **Revenue recognition**

Revenues from license agreements are recognized when milestones are achieved, in accordance with the related agreements. License revenue, if the underlying deliverable has no stand-alone value to the customer, is deferred and recognized over the term for which substantive contractual obligations exist. This may involve estimates by management to determine the term of such obligations. Amounts received in advance of recognition of revenue are included in deferred revenue.

## **RESULTS OF OPERATIONS**

### **Quarter ended September 30, 2006 compared with the Quarter ended September 30, 2005**

The Company incurred a net loss of \$6,174,436 or \$0.22 per common share for the third quarter of 2006, compared with a net loss of \$3,156,878 or \$0.34 per common share for the same quarter last year. The acquisition of Ambrilia France on March 1, 2006, represented the merger of two companies of similar size and the results for the current quarter, which fully include those of Ambrilia France, thus reflect this growth.

### **Revenues**

Revenues for the third quarter of 2006 were \$134,611, compared with \$46,611 in the corresponding quarter last year. The higher revenues resulted primarily from an increase in interest income, due to an increase in interest rates in the current quarter compared to the third quarter of 2005.

The Company's revenues have been earned primarily from interest on available cash balances and short-term investments. We expect to continue to receive such revenues during the next several years, as well as licensing revenues to be earned as our products advance through clinical development and the revenues expected from Octreotide and Goserelin following their launch, which is currently projected to be in 2008 and 2009, respectively.

## **Research and Development Expenses**

Research and development expenses amounted to \$3,025,841 in the third quarter of 2006, compared with \$1,788,168 in the same quarter last year. The increase of \$1,237,673 resulted primarily from the R&D expenditures on Octreotide and Goserelin added as a result of the acquisition of Ambrilia France, as well as higher spending on PPL-100 and a provision for 2006 bonuses. These were only partially offset by reduced expenditures for PCK3145 and government assistance of \$230,281 under the National Research Council Canada Industrial Research Assistance Program ("IRAP") to fund the technologies of a clinical program. Funding for up to \$980,000 of research expenditures is being provided by an IRAP contribution, of which \$469,479 had been received by September 30, 2006. Tax credits increased to \$389,042 in the current quarter from \$120,000 in the corresponding quarter last year, due to the higher level of expenses in the current quarter.

Our research and development expenses consist primarily of salaries and related personnel costs, fees paid to external service providers, laboratory supplies and costs for leasing of facilities and equipment. In the third quarter of 2006, fees paid to external service providers were primarily related to pre-clinical costs for PPL-100 and material for clinical studies for Octreotide.

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

## **General and Administrative Expenses**

General and administrative expenses amounted to \$1,656,614 in the third quarter of 2006, an increase of \$691,225 over the total of \$965,389 for the same quarter last year. Expenses at our regional office in Paris, together with a provision for 2006 bonuses and higher professional fees, were the principal reason for the increased expenses.

## **Other Expenses**

Amortization expense increased to \$2,177,128 in the current quarter from \$278,656 in the same quarter last year. The increase resulted almost entirely from the added amortization on intellectual property arising from the acquisition of Ambrilia France on March 1, 2006.

Interest on long-term debt was \$302,191 in the third quarter of 2006, compared to \$242,558 in the same quarter last year. The increase was due to the interest expense on the Biolevier loan, which increased as a result of the loan interest being capitalized and added to the outstanding balance of the loan, as well as to the increase in interest rates compared to the third quarter of 2005.

Accretion expense on the convertible debentures amounted to \$63,745 in the third quarter of 2006 compared to \$56,947 in the third quarter of 2005. This ongoing non-cash accounting charge for imputed interest will increase the carrying value of the convertible debentures to their face value of \$3,500,000 by their June 29, 2010 maturity date.

The foreign exchange gain for the third quarter of 2006 amounted to \$42,369, compared to a gain of \$17,057 in the same quarter last year. The amount in the current quarter reflects primarily the translation gain on the consolidation of Ambrilia France.

As a consequence of the intellectual property arising on the acquisition of Ambrilia France, a future income tax liability of \$9,694,945 was recorded on March 1, 2006 as part of the acquisition equation for accounting purposes. This amount is being drawn down over a term of up to the 7-year period during which the intellectual property is being amortized. This resulted in a future income tax recovery on the consolidated statement of

operations of \$585,514 for the third quarter of 2006. This was partially offset by a foreign exchange loss for the current quarter of \$56,615 relating to the future income tax liability.

### **Nine Months ended September 30, 2006 compared with the Nine Months ended September 30, 2005**

During the nine months ended September 30, 2006, the Company incurred a net loss of \$15,141,053 or \$0.64 per common share, compared with a net loss of \$9,450,982 or \$1.07 per common share for the nine months ended September 30, 2005.

#### **Revenues**

Revenues of \$435,481 were earned in the first nine months of 2006, compared with \$221,347 in the same period last year. The increase was primarily the result of higher interest income, due to improved interest rates compared to the first nine months of 2005.

#### **Research and Development Expenses**

Research and development expenses for the nine months ended September 30, 2006 were \$7,802,536, an increase of \$1,706,719 over the total of \$6,095,817 in the corresponding period last year. Spending on Octreotide and Goserelin accounted for approximately \$2.9 million in the current period, which together with increased spending on TVT-Dox and PPL-100 and a provision for 2006 bonuses more than offset reduced research expenses in all other areas in addition to the \$699,760 of government assistance under the IRAP agreement. Tax credits earned increased to \$978,106 in the first nine months of 2006 from \$696,000 in the same period last year, reflecting the higher level of research and development spending in the current period.

#### **General and Administrative Expenses**

General and administrative expenses amounted to \$4,312,379 in the first nine months of 2006, an increase of \$1,724,929 over the total of \$2,587,450 for the corresponding period last year. The increase was primarily due to the added expenses at our regional office in Paris, together with a provision for 2006 bonuses, higher professional fees, building occupancy costs and expenses relating to the integration of the new business, which were only partially offset by lower salary costs in Canada.

#### **Other Expenses**

Amortization expense increased to \$5,150,496 from \$700,252 in the same period last year. The increase resulted primarily from the inclusion of the amortization of intellectual property arising on the acquisition of Ambrilia France on March 1, 2006.

Interest on long-term debt increased to \$854,784 from \$586,244 in the first nine months of 2005. The increase resulted from the interest on the convertible debentures issued on June 29, 2005, together with higher interest on the Biolevier loan due to the combined effect of higher interest rates and the increased loan balance resulting from the ongoing capitalization of interest on the loan.

Accretion expense on the convertible debentures amounted to \$185,968 in the current period, compared to \$56,947 in the corresponding period last year. The debentures were issued only on June 29, 2005, which accounted for the lower accretion in the 2005 period. This ongoing non-cash accounting charge for imputed interest will increase the carrying value of the convertible debentures to their face value of \$3,500,000 by their June 29, 2010 maturity date.

The foreign exchange loss for the first nine months of 2006 amounted to \$89,985, compared to a gain of \$23,278 in the corresponding period last year. The amount in the current period reflects primarily the translation loss on the consolidation of Ambrilia France due to a strengthening of the Euro against the Canadian dollar.

Restructuring charges in the first nine months of 2006 amounted to \$251,120, compared with \$172,279 in the same period last year. The current period amount followed the acquisition of Ambrilia France, while the charge in the prior period resulted from the corporate restructuring undertaken in January 2005.

The future income tax recovery in the current period relating to the future income tax liability arising on the acquisition of Ambrilia France amounted to \$1,832,390. In addition, a foreign exchange gain of \$345,761 relating to the future income tax liability was also recorded in the period.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company has financed its operations and its acquisitions of technology and capital assets primarily through private placements and public issues of common shares and convertible debentures, scientific research investment tax credits and other government assistance, interest income and amounts received under licensing agreements for certain of its products. A loan agreement entered into in December 2002 expanded the Company's financing base by providing it with a loan facility of \$10 million obtained under the Biolevier program of the Government of Québec, from which an amount of \$9 million has been drawn to-date. The balance of this facility has been cancelled. \$2 million of the outstanding balance is to be repaid within 60 days of receipt of the US\$17 million upfront licensing fee received in October 2006 from its licensee for PPL-100. On March 1, 2006, concurrent to the Ambrilia France acquisition, an amount of \$18,095,904 was obtained from a private placement of common shares and warrants, before cash expenses of \$1,231,123.

In accordance with the provisions governing the 4,000,000 outstanding Series 1 First Preferred Shares of the Company (the "Preferred Shares"), the holder of such shares has recently requested, subsequent to the end of the third quarter of 2006, their redemption by the Company at their issue price of \$ 4,000,000. In accordance with such provisions, the Company has elected not to redeem the Preferred Shares, but to convert them into common shares of the Company. Consequently, all of the outstanding Preferred Shares will be so converted, effective November 16, 2006, at a market-based conversion price of \$4.13 per common share, as stipulated in the Preferred Shares, which will result in 968,523 common shares of the Company being issued to the holder of the Preferred Shares.

Cash and cash equivalents and short-term investments totaled \$8,536,294 at September 30, 2006, compared with \$5,360,158 at December 31, 2005. The increase of \$3,176,136 resulted from the net proceeds of \$16,864,781 obtained from the March 1, 2006 financing. This amount was partially offset by the utilization of \$11,281,704 to finance operating activities for the first nine months of 2006, including an increase of \$265,017 in non-cash working capital. This increase in non cash working capital was after deducting an increase in deferred revenues of \$564,900 for a milestone payment received in July 2006. In addition, a net amount of \$630,598 was used in the period for additional property, plant and equipment and intellectual property. In addition, cash expenses of \$1,979,031 were incurred in connection with the acquisition of Ambrilia France on March 1, 2006, which was carried out on a share exchange basis. Cash of \$174,625 was obtained with the acquisition.

The semi-annual interest expense on the \$3,500,000 of convertible debentures issued in June 2005 is payable either in cash or common shares, at the option of the Company. To-date, the Company has elected to pay the interest in shares.

On July 28, 2006, Ambrilia received a milestone payment of \$564,900 (US\$500,000) under a US licensing agreement with a major US pharmaceutical company for Octreotide. The payment became due upon the Company manufacturing sterile batches of Octreotide which met stability and cGMP compliance, as per the FDA guidelines.

Cash, cash equivalents and short term investments at September 30, 2006 amounted to \$8.5 M which, together with the upfront licensing fee of \$19.2 M (US\$17 M) received in October, increased to \$27.7 M Based on the

Company's current rate of spending, management expects to have sufficient cash to support its ongoing activities for at least the next 18 months.

## **SIGNIFICANT PROJECTS**

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

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

A summary of the Company's contractual obligations as at December 31, 2005 was disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2005. The amount of these contractual obligations increased during the nine months ended September 30, 2006 as a result of the Ambrilia France acquisition and move by the Company in March 2006 to an integrated head office and laboratories facility in Montreal. The contractual obligations from these transactions are as follows:

(in thousands of dollars)	Payments due by period				Total
	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	
Lease commitments	483	965	920	1,045	3,413

Other than in the normal course of business, the Company has not entered into any other off-balance sheet arrangements during the quarter ended September 30, 2006 and does not expect to enter into any in the near future.

There were no material commitments for capital expenditures as at September 30, 2006

## **RELATED PARTY TRANSACTIONS**

There has been no material change during the quarter ended September 30, 2006.

## **PROPOSED TRANSACTIONS**

The Company continually reviews opportunities for new technologies that could increase shareholder value. At the present time, the Company has not entered into any agreements involving the acquisition or disposition by the Company of assets or businesses.

## **CHANGES IN ACCOUNTING POLICIES**

Section 3831, Non-Monetary Transactions was adopted effective January 1, 2006. The adoption has no material impact on the Company's financial position or results of operations.

## **FINANCIAL INSTRUMENTS**

The Company does not use currency or other hedging instruments.

## **OUTSTANDING SHARE DATA**

As of October 31, 2006 there are 4,000,000 First Preferred Shares, Series 1 outstanding, unchanged from December 31, 2005. The number of common shares outstanding as of October 31, 2006 is 28,022,388, an increase of 18,562,579 from December 31, 2005, resulting from 18,504,656 shares issued in connection with the acquisition of Ambrilia France and the concurrent financing, together with the 57,923 shares issued on June 29, 2006 in payment of interest on the convertible debentures. The number of stock options outstanding at October 31, 2006 is 554,876, an increase of 150,134 from December 31, 2005. The increase resulted from a total of 242,648 new options having been granted during the period, partially offset by 92,514 options which expired or were forfeited. In addition, 10,759,810 warrants are outstanding on October 31, 2006, compared to 1,865,468 at December 31, 2005. The increase resulted from the financing on March 1, 2006, which resulted in the issue of warrants to purchase 7,867,775 common shares of Ambrilia at \$3.50 per share and broker warrants to purchase 370,143 common shares at \$2.30 per share with warrants to purchase an additional 370,143 common shares at \$3.50 per share, together with the issue of 1,494,330 acquisition warrants on March 1, 2006, of which 149,424 were exercised on September 29, 2006. These were partially offset by the expiry without value on April 7, 2006 of 1,043,625 warrants issued through a public offering on April 7, 2004 and on April 17, 2006 of 15,000 warrants issued in connection with a business acquisition in 2003.

## **RISKS AND UNCERTAINTIES**

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

The Company can make no assurance that its products will be developed successfully or receive regulatory approval. The new products of the Company are currently in the research and development stages. The Company can make no assurance that its research and development programs will result in commercially viable products. To achieve profitable operation, the Company, alone or with others, must successfully develop and market its products. To obtain regulatory approvals for the products being developed, clinical trials must demonstrate efficacy and that the products are safe for human use. Unsatisfactory results obtained from a particular study relating to a program may cause the Company or its collaborators to abandon its commitment to that program. The Company can make no assurance that any future animal or human test will yield favourable results. The Company also can make no assurance that products based on its technology, if approved for marketing, will achieve market acceptance. The degree of market acceptance will depend on the efficacy and safety of the product candidates, their potential advantage over alternative products and treatment method. The lack of such market acceptance would have a material adverse effect on the Company's business and financial condition.

To develop its technologies, the Company requires significant investment of financial resources. Consequently, the ability of the Company to obtain the cash needed to finance its operations is fundamental to its future success and therefore constitutes a business risk.

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

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

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(unaudited)

As at	September 30, 2006 \$	December 31, 2005 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	6,578,654	417,953
Short-term investments	1,957,640	4,942,205
Accounts receivable <i>[note 4]</i>	672,165	1,707,890
Investment tax credits recoverable	1,486,972	2,202,487
Prepaid expenses	178,005	668,428
	<b>10,873,436</b>	<b>9,938,963</b>
Long-term receivables <i>[note 5]</i>	883,858	-
Property, plant and equipment	1,843,391	600,653
Intellectual property	54,137,812	8,165,089
Deferred financing fees	1,019,822	993,563
	<b>68,758,319</b>	<b>19,698,268</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	2,985,811	1,798,126
Deferred revenues	3,384,461	-
Loan payable <i>[note 3]</i>	707,492	-
	<b>7,077,764</b>	<b>1,798,126</b>
Minority interest <i>[note 3]</i>	1	-
Biolevier loan facility	10,794,003	10,122,969
Convertible debentures	2,342,990	2,157,022
Future income tax liability	7,767,885	-
Preferred shares	4,000,000	4,000,000
	<b>31,982,643</b>	<b>18,078,117</b>
<b>Shareholders' equity <i>[note 6]</i></b>		
Share capital	109,239,307	65,004,736
Warrants	6,143,141	2,952,462
Contributed surplus	7,737,797	4,866,469
Equity component of convertible debentures	1,920,914	1,920,914
Deficit	(88,265,483)	(73,124,430)
	<b>36,775,676</b>	<b>1,620,151</b>
	<b>68,758,319</b>	<b>19,698,268</b>

Commitments and guarantees *[note 7]*

See accompanying notes

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED STATEMENTS OF**  
**OPERATIONS AND DEFICIT**

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
<b>REVENUES</b>				
License revenue	6,857	-	15,845	-
Interest and other income	127,754	46,611	419,636	221,347
	<b>134,611</b>	46,611	<b>435,481</b>	221,347
<b>EXPENSES</b>				
Research and development [note 9]	3,025,841	1,788,168	7,802,536	6,095,817
Research and development tax credits	(389,042)	(120,000)	(978,106)	(696,000)
Net research and development	2,636,799	1,668,168	6,824,430	5,399,817
General and administrative	1,656,614	965,389	4,312,379	2,587,450
Amortization of property, plant and equipment	122,623	62,189	296,803	184,322
Amortization of intellectual property	2,014,217	181,181	4,738,959	429,377
Amortization of deferred financing fees	40,288	35,286	114,734	86,553
Accretion on convertible debentures	63,745	56,947	185,968	56,947
Interest on long-term debt	302,191	242,558	854,784	586,244
Restructuring charges [note 8]	-	-	251,120	172,279
Financial charges	43,838	8,828	85,523	12,920
Foreign exchange losses (gains)	(42,369)	(17,057)	89,985	(23,278)
	<b>6,837,946</b>	3,203,489	<b>17,754,685</b>	9,492,631
Loss before write-down of intellectual property and income taxes	(6,703,335)	(3,156,878)	(17,319,204)	(9,271,284)
Write-down of carrying value of intellectual property	-	-	-	179,698
<b>Loss before income taxes</b>	<b>(6,703,335)</b>	<b>(3,156,878)</b>	<b>(17,319,204)</b>	<b>(9,450,982)</b>
Future income tax recovery	585,514	-	1,832,390	-
Foreign exchange gain (loss) on future income tax liability	(56,615)	-	345,761	-
	<b>528,899</b>	-	<b>2,178,151</b>	-
<b>Net loss</b>	<b>(6,174,436)</b>	<b>(3,156,878)</b>	<b>(15,141,053)</b>	<b>(9,450,982)</b>
Deficit, beginning of period	(82,091,047)	(66,508,500)	(73,124,430)	(60,214,396)
<b>Deficit, end of period</b>	<b>(88,265,483)</b>	<b>(69,665,378)</b>	<b>(88,265,483)</b>	<b>(69,665,378)</b>
<b>Basic and diluted loss per share [note 2]</b>	<b>(0.22)</b>	<b>(0.34)</b>	<b>(0.64)</b>	<b>(1.07)</b>
<b>Weighted average number of common shares outstanding [note 2]</b>	<b>27,543,885</b>	<b>9,407,746</b>	<b>23,607,043</b>	<b>8,817,643</b>

See accompanying notes

**AMBRILIA BIOPHARMA INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Net loss	(6,174,436)	(3,156,878)	(15,141,053)	(9,450,982)
Items not affecting cash				
Amortization of property, plant and equipment	122,623	62,189	296,803	184,322
Amortization of intellectual property	2,014,217	181,181	4,738,959	429,377
Amortization of deferred financing fees	40,288	35,286	114,734	86,553
Write-down of carrying value of intellectual property	-	-	-	179,698
Accretion on convertible debentures	63,745	56,947	185,968	56,947
Loan interest capitalized	240,941	179,462	671,034	523,148
Interest paid by issuance of common shares <i>[note 6]</i>	-	-	122,164	-
Future income tax recovery and related foreign exchange gain	(528,899)	-	(2,178,151)	-
Services paid by issuance of stock options <i>[note 6]</i>	36,820	108,576	172,855	362,633
	(4,184,701)	(2,533,237)	(11,016,687)	(7,628,304)
Net change in non-cash balances relating to operations	1,682,529	(919,332)	(265,017)	(1,843,180)
<b>Cash flows related to operating activities</b>	<b>(2,502,172)</b>	<b>(3,452,569)</b>	<b>(11,281,704)</b>	<b>(9,471,484)</b>
<b>INVESTING ACTIVITIES</b>				
Acquisition of intellectual property	(42,712)	(50,039)	(189,873)	(173,580)
Acquisition of property, plant and equipment	(139,353)	(4,145)	(441,040)	(14,778)
Proceeds on disposal of property, plant and equipment	-	-	315	11,153
Cash and cash equivalents obtained on acquisition of business <i>[note 3]</i>	-	-	174,625	253,311
Business acquisition costs <i>[note 3]</i>	-	(159,131)	(1,979,031)	(179,131)
Purchase of short-term investments	-	(1,490,265)	(3,935,960)	(4,960,270)
Maturities of short-term investments	1,978,320	1,987,180	6,920,525	17,388,222
<b>Cash flows related to investing activities</b>	<b>1,796,255</b>	<b>283,600</b>	<b>549,561</b>	<b>12,324,927</b>
<b>FINANCING ACTIVITIES</b>				
Issuance of common shares <i>[note 6]</i>	-	-	18,095,904	-
Share issuance costs <i>[note 6]</i>	(7,513)	-	(1,231,123)	-
Debt issuance costs	-	(299,120)	-	(343,176)
Repayment of long-term debt assumed in an acquisition	-	(137,500)	-	(275,000)
Issuance of convertible debentures	-	-	-	3,500,000
<b>Cash flows related to financing activities</b>	<b>(7,513)</b>	<b>(436,620)</b>	<b>16,864,781</b>	<b>2,881,824</b>
Effect of exchange rate changes on cash	(8,086)	-	28,063	-
Net increase (decrease) in cash and cash equivalents	(713,430)	(3,605,589)	6,132,638	5,735,267
Cash and cash equivalents, beginning of period	7,300,170	9,660,238	417,953	319,382
<b>Cash and cash equivalents, end of period</b>	<b>6,578,654</b>	<b>6,054,649</b>	<b>6,578,654</b>	<b>6,054,649</b>
<b>Supplemental cash flow information</b>				
Cash paid during the period for interest	8,068	8,956	17,963	9,303

See accompanying notes

## Ambrilia Biopharma Inc.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

### 1. Description of business

Ambrilia Biopharma Inc. [the "Company"] is a biopharmaceutical company engaged in the development and commercialization of diagnostics and therapeutic drugs. It was incorporated under the laws of the Province of Ontario in 1986 and was continued under the *Canada Business Corporations Act* in 2001. On March 1, 2006, the Company changed its name from Procyon Biopharma Inc. to Ambrilia Biopharma Inc.

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

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

These interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles for interim financial statements and follow the same accounting policies and methods of application as the most recent annual consolidated financial statements, except as noted below. The interim consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the most recent annual consolidated financial statements as at and for the year ended December 31, 2005.

On October 13, 2006, the Company effected a share consolidation on the basis of one new common share for each ten common shares held. The consolidation affects all of the Company's outstanding common shares and convertible securities, such as options, warrants, preferred shares and convertible debentures. All applicable numbers of shares and other securities in this report, as well as per-share data, have been adjusted to reflect this change on a retrospective basis.

#### Basis of consolidation

The consolidated financial statements include the accounts of the Company, those of its 88.10%-owned French subsidiary, Ambrilia Biopharma France S.A. (formerly Cellpep S.A.) and which is considered to be an integrated subsidiary [note 3], those of its wholly-owned U.S. subsidiary, Oncologic Biopharmaceuticals Corporation, and those of its wholly-owned Canadian subsidiary, Bioxalis Medica Inc., which was purchased on June 29, 2005.

#### Revenue recognition

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

Up-front non-refundable licensing revenue is deferred and recognized on a straight-line basis over the term during which the Company maintains substantive contractual obligations. Licensing revenue received upon the achievement of milestones is recognized when the underlying condition is met if it has stand-alone value to the customer, the Company has no further obligations in relation to that milestone and collectibility is reasonably assured. Otherwise, it is recognized over the remaining term of the underlying agreement. Amounts received in advance of recognition are included in deferred revenues, as are amounts that are refundable if underlying conditions are not met.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

#### 3. Business acquisition

Effective March 1, 2006, the Company acquired 87.117% of the outstanding shares of Cellpep S.A., a French private biotechnology company developing therapeutics in oncology and infectious diseases, in exchange for 10,162,762 common shares of Ambrilia valued at \$32,520,883, based on the \$3.20 weighted-average closing price of the Company's common shares for the five trading days around January 19, 2006, the date on which the proposed transaction was announced. The acquisition has been accounted for using the purchase method at fair value. The consolidated results of operations of Cellpep S.A. and its wholly-owned Canadian subsidiary, Cellpep Pharma Inc. and its 50%-owned Canadian subsidiary, Opep Pharma Inc. have been consolidated with the accounts of the Company since the date of acquisition. At the same date, the Company completed the acquisition of the remaining 50% of Opep Pharma Inc. for a cash consideration of \$1.

The allocation of the purchase price is as follows:

	\$
Cash and cash equivalents	174,625
Accounts receivable	323,178
Investment tax credits recoverable	305,153
Inventory	281,293
Prepaid expenses	51,617
Long-term receivables	321,723
Property, plant and equipment	1,098,816
Intellectual property	49,792,529
<b>Total assets acquired</b>	<b>52,348,934</b>
Accounts payable and accrued liabilities	4,612,254
Loan payable	676,142
Deferred revenues	2,865,678
Future income tax liability	9,694,945
Minority interest	1
<b>Total liabilities assumed</b>	<b>17,849,020</b>
<b>Net assets acquired</b>	<b>34,499,914</b>
Consideration paid represented by:	
Share capital <i>[note 6]</i>	32,520,883
Acquisition costs	1,979,031
	<b>34,499,914</b>

Since Cellpep S.A. was in a negative equity position at the transaction date and since the minority shareholders have no responsibility to contribute to this deficiency, the minority interest has been assigned a nominal value of \$1 in this purchase price equation.

Of the assets acquired, an amount of \$49,792,529 was assigned to intellectual property, which is being amortized on a straight-line basis over a 7-year period.

The loan payable bears interest at 12% payable annually and relates to convertible debentures issued by Cellpep S.A. on May 31, 2005. The holder elected on December 7, 2005 to request repayment of the loan by March 1, 2007, being 12 months following a liquidity event as defined under the terms of the loan, in this case the acquisition of Cellpep S.A. As a result, the right to convert no longer exists and the loan has been classified as a short-term liability.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

Under a Share Exchange Agreement between the Company and the majority of the remaining Cellpep S.A. shareholders, an additional 9.39% of the outstanding securities of Cellpep S.A. will be acquired in exchange for 1,494,330 common shares of the Company in four tranches during the period ending March 1, 2008. The Company holds a call option on these Cellpep S.A. securities, which it intends to exercise according to the following schedule: 10% from September 1 to October 1, 2006, a further 30% from March 1 to April 1, 2007, 30% from September 1 to October 1, 2007 and the final 30% from March 1 to April 1, 2008. The Cellpep S.A. shareholders hold Acquisition Warrants issued by the Company entitling them to receive the Company's shares according to the same schedule. The fair value of the call option and Acquisition Warrants are assumed to be nil on the date they were issued.

On April 21, 2006, Cellpep S.A. changed its name to Ambrilia Biopharma France S.A. ("Ambrilia France"). On the same date, to comply with French legal requirements, the Company invested an additional Euros 105,050 (\$147,932) in exchange for 2,500 shares of Ambrilia France. As a result, the Company's ownership of Ambrilia France increased from 87.117% to 87.16%.

On September 29, 2006, the Company exercised its call option to acquire the initial 10% tranche of the 9.39% of the outstanding Ambrilia France securities covered by the Share Exchange Agreement and described above, issuing 149,424 common shares of the Company in exchange, which increased the Company's ownership of Ambrilia France to 88.10%. The shares issued were valued at \$478,189, based on the \$3.20 weighted-average closing price of the Company's common shares for the five trading days around January 19, 2006, the date on which the acquisition was first announced. Accordingly an amount of \$729,280 and \$251,091 was assigned to intellectual property and future income tax liability respectively.

#### 4. Accounts receivable

	September 30, 2006	December 31, 2005
	\$	\$
Collateralized advance to Opep Pharma Inc.	-	1,500,000
Commodity taxes recoverable	<b>272,504</b>	152,595
Government assistance receivable <i>[note 9]</i>	<b>230,281</b>	-
Interest receivable on short-term investments	<b>52,405</b>	26,272
Other	<b>116,975</b>	29,023
	<b>672,165</b>	1,707,890

Effective March 1, 2006 Opep Pharma Inc. became a wholly-owned subsidiary of the Company. Consequently, the advance to Opep Pharma Inc. is now an inter-company balance which is eliminated on consolidation.

#### 5. Long-term receivables

The long-term receivables at September 30, 2006 are as follows:

	\$
Deposits on long-term leases	450,560
Investment tax credits recoverable in more than one year	433,298
	883,858

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

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

#### 6. Capital stock

##### Common shares

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

	Number of shares	Share capital \$
Balance as at December 31, 2005	9,459,809	65,004,736
Acquisition of Ambrilia France on March 1, 2006	10,162,762	32,520,883
Additional Ambrilia France shares acquired on September 29, 2006	149,424	478,189
Private placement March 1, 2006	7,867,775	12,588,455
Share issuance costs - cash	-	(858,720)
Share issuance costs – broker compensation warrants	-	(616,400)
Issued in payment of interest on convertible debentures	57,923	122,164
Balance as at September 30, 2006	27,697,693	109,239,307

On March 1, 2006, concurrent to the acquisition of Ambrilia France, the Company completed a financing of \$18,095,904, before issue expenses, by way of a private placement of 7,867,775 common shares at \$2.30 per share, with warrants to purchase an equal number of additional common shares at \$3.50 per share to March 1, 2011. Cash expenses of the financing amounted to \$1,231,123, which has been allocated to share capital (\$858,720) and warrants (\$372,403), while broker compensation warrants were granted to the underwriters to purchase up to 370,143 common shares at \$2.30 per share, with warrants to purchase an equal number of common shares at \$3.50 per share to March 1, 2011. The fair value of the broker warrants is estimated at \$886,075, determined using the Black-Scholes option pricing model with a volatility of 57%, a risk-free interest rate of 4%, a dividend yield of nil and an expected life of two years. The net proceeds of \$15,978,706 have been allocated to share capital (\$11,113,335) and warrants (\$4,865,371), using the Black-Scholes option pricing model with a volatility of 68%, a risk-free interest rate of 4.1%, a dividend yield of nil and an expected life of five years. The fair value of the broker warrants of \$886,075 is allocated to share capital (\$616,400) and warrants (\$269,675) and is included in the expenses deducted in determining the above net proceeds, with a corresponding increase of \$886,075 to contributed surplus.

On June 29, 2006, the Company elected to issue 57,923 common shares as payment for the cumulative interest for the six months ended on that date on the \$3,500,000 convertible debentures maturing June 29, 2010.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

#### Stock option plan

As at September 30, 2006, there were 546,917 stock options outstanding, compared to 404,742 at December 31, 2005.

	Nine months ended September 30,			
	2006		2005	
	Number	Weighted average exercise price	Number	Weighted average exercise price
		\$		\$
Options outstanding, beginning of period	404,742	7.61	492,933	8.34
Granted	232,523	2.49	34,500	4.20
Forfeited	(28,998)	6.10	(72,314)	8.35
Expired	(61,350)	7.51	(46,750)	11.14
Options outstanding, end of period	546,917	5.48	408,369	7.60
<b>Exercisable</b>	<b>330,496</b>	<b>7.48</b>	<b>292,026</b>	<b>7.58</b>

All options granted were with exercise prices equal to the market price of the Company's shares at the date of grant. Compensation expense of \$165,429 (2005 - \$298,699) has been recognized in the first nine months of 2006 for stock options granted to employees and directors and an additional amount of \$7,426 (2005 - \$63,934) has been expensed for options granted to consultants. The fair value of options granted during the period was determined using the Black-Scholes option pricing model with a volatility factor of from 56% to 69%, a risk-free interest rate of approximately 4%, a dividend yield of nil and an expected life of the options of 5 years for employees and directors and 2 years for consultants.

#### Warrants

	Number of common shares reserved for issuance	\$
Balance as at December 31, 2005	1,865,468	2,952,462
Issued in connection with March 1, 2006 private placement	7,867,775	5,507,449
Issuance costs related to private placement	-	(645,365)
Broker compensation warrants for private placement	370,143	-
Warrants from broker compensation warrants	370,143	-
Acquisition warrants, net [note 3]	1,344,906	-
Expired warrants	(1,058,625)	(1,812,398)
Extension to expiry date of Investissement Quebec warrants	-	140,993
Balance as at September 30, 2006	10,759,810	6,143,141

On March 1, 2006 the Company issued warrants to purchase 7,867,775 common shares at an exercise price of \$3.50 per share in a private placement of common shares concurrent to the acquisition of Ambrilia France (see 'Common shares' above).

On April 24, 2006, having received the approval of the Toronto Stock Exchange and in accordance with the terms of the Biolevier loan facility, the expiry date of the warrants to purchase 150,375 common shares held by Investissement Quebec was extended by five years to February 6, 2013. The fair value of this extension, determined using the Black-Scholes option pricing model with a volatility factor of 68%, a risk-free interest rate of 4.3% and a dividend yield of nil amounts to \$140,993 and is recorded as deferred financing costs and amortized to expense, together with the unamortized balance of the fair value of the warrants previously recorded, over the remaining term of the facility.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

#### Contributed surplus

	\$
Balance as at December 31, 2005	4,866,469
Compensation warrants issued to underwriters	886,075
Options granted to employees and directors	165,429
Options issued to consultants	7,426
Warrants expired in period	1,812,398
Balance as at September 30, 2006	7,737,797

#### 7. Commitments and guarantees

Effective March 1, 2006 the Company entered into an operating lease for office and laboratory premises located in Verdun, Quebec. Also, as a result of the acquisition of Ambrilia France on March 1, 2006, the Company is committed until June 2008 under an operating lease for offices in Paris. The additional minimum annual payments from these leases are as follows:

	\$
2006 (3 months)	118,000
2007	487,000
2008	522,000
2009	428,000
2010 and thereafter	1,858,000
	3,413,000

#### 8. Restructuring charges

Following the acquisition of Ambrilia France, the Company incurred restructuring charges relating to severance payments and lease termination costs, as follows:

	\$
Severance payments	160,933
Lease termination costs	90,187
	251,120

#### 9. Government assistance

Under an agreement with the National Research Council Canada Industrial Research Assistance Program to provide a contribution of up to \$980,000 to help fund the clinical development of one of the Company's technologies, the Company recorded, for the nine months ended September 30, 2006, \$699,760 of government assistance as a reduction of research and development expenses [\$230,281, for the three-month period ended September 30, 2006]. The balance of the contribution is expected to be advanced prior to March 31, 2007 and represents reimbursement of 38% of the cost of fees paid to contractors for the project.

Repayment of the contribution is subject to certain terms and conditions based on gross revenues as defined by the agreement, but will not commence before January 1, 2009 and will continue up to January 1, 2019, or until a maximum of 150% of the total amount advanced under the agreement is repaid, if earlier.

## Ambrilia Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(unaudited)

#### 10. Subsequent events

- (a) On October 4, 2006, the Company acquired an additional 3.376% of the shares of Ambrilia France from a minority shareholder in exchange for 324,695 common shares of the Company. This represented an acceptance of the Company's offer under the Share Exchange Agreement effective March 1, 2006. Following this transaction, the Company's ownership of Ambrilia France increased to 91.48%.
- (b) On October 12, 2006, the Company announced that it had entered into an exclusive licensing agreement granting the worldwide rights to its HIV/AIDS protease inhibitor program to an affiliate of Merck & Co., Inc. Under the terms of the agreement, the Company received an upfront licensing fee of US\$17 million and is eligible to receive milestone payments totaling up to US\$215 million and royalties on all future product sales. In exchange for obtaining from Investissement Quebec a release on the mortgage related to the licensed technology, the Company agreed to a revised Biolevier loan repayment formula. This includes an amount of \$2 million to be repaid within 60 days of receipt by the Company of the US\$17 million upfront licensing fee. In addition, the \$1 million undrawn balance of this loan facility has been cancelled.
- (c) In accordance with the provisions governing the 4,000,000 outstanding Series 1 First Preferred Shares of the Company (the "Preferred Shares"), the holder of such shares has recently requested, subsequent to the end of the third quarter of 2006, their redemption by the Company at their issue price of \$ 4,000,000. In accordance with such provisions, the Company has elected not to redeem the Preferred Shares, but to convert them into common shares of the Company. Consequently, all of the outstanding Preferred Shares will be so converted, effective November 16, 2006, at a market-based conversion price of \$4.13 per common share, as stipulated in the Preferred Shares, which will result in 968,523 common shares of the Company being issued to the holder of the Preferred Shares.