

keep on

# table of contents

- 02 The year at a glance
- 03 Our product pipeline
- 04 Letter to Shareholders
- 06 Oncology assets
- 07 Antiviral and Immunomodulators assets
- 08 Corporate governance, Board of Directors and Shareholders information



# going

## executing our strategy

Montreal-based Ambrilia Biopharma Inc. (TSX:AMB) is a biotechnology company engaged in the discovery and development of novel treatments for viral diseases and cancer. Ambrilia's product portfolio is comprised of oncology and antiviral assets, including two new formulations of existing peptides for cancer treatment, a therapeutic peptide for prostate cancer, a targeted delivery technology for cancer, an HIV protease inhibitor program (exclusive worldwide rights granted to Merck & Co., Inc.) as well as HIV integrase and entry inhibitors, Hepatitis C virus inhibitors and anti-Influenza A compounds.

corporate profile  
going further

“We undertook a number of initiatives... to streamline the organization while pushing ahead with development work aimed at helping the Company extract maximum value from the sale or licensing of its oncology programs.”

— **Philippe Calais**, Ph.D., Pharm.  
President and Chief Executive Officer

#### THE YEAR AT A GLANCE

##### **JANUARY 2008**

- Philippe Calais, Ph.D., Pharm. becomes President & CEO and a member of the Board of Directors
- Phase III preliminary data show the safety and efficacy of Ambrilia’s proprietary prolonged-release formulation of C2L octreotide in acromegaly patients

##### **MAY 2008**

- Positive top line results from 24-week Phase III study comparing efficacy and safety of Octreotide C2L administered every 6 weeks versus Sandostatin®LAR 30 mg administered every 4 weeks
- Termination of U.S. license agreement with Covidien expands divestment opportunity for C2L
- Final three-month-release formulation of goserelin for the treatment of prostate cancer achieved

##### **JUNE 2008**

- Antivirals portfolio comprised of small molecules and peptides targeting HIV/AIDS, Hepatitis C and Influenza A unveiled at Annual General Meeting
- Researchers validate the in-vivo proof of concept with Ambrilia’s targeted NGR-delivery technology applied to a carrier containing a si-RNA (small interfering RNA)

##### **JULY 2008**

- Clinical program for novel three-month goserelin formulation in treatment of prostate cancer initiated
- Merck & Co places a clinical-development hold on Ambrilia’s HIV protease inhibitor lead compound PPL-100

##### **SEPTEMBER 2008**

- Goserelin product offering expanded with novel one-month formulation
- Ambrilia prioritizes divestment strategy and takes cost-cutting measures in response to deteriorating business environment — antiviral R&D put on hold

##### **OCTOBER 2008**

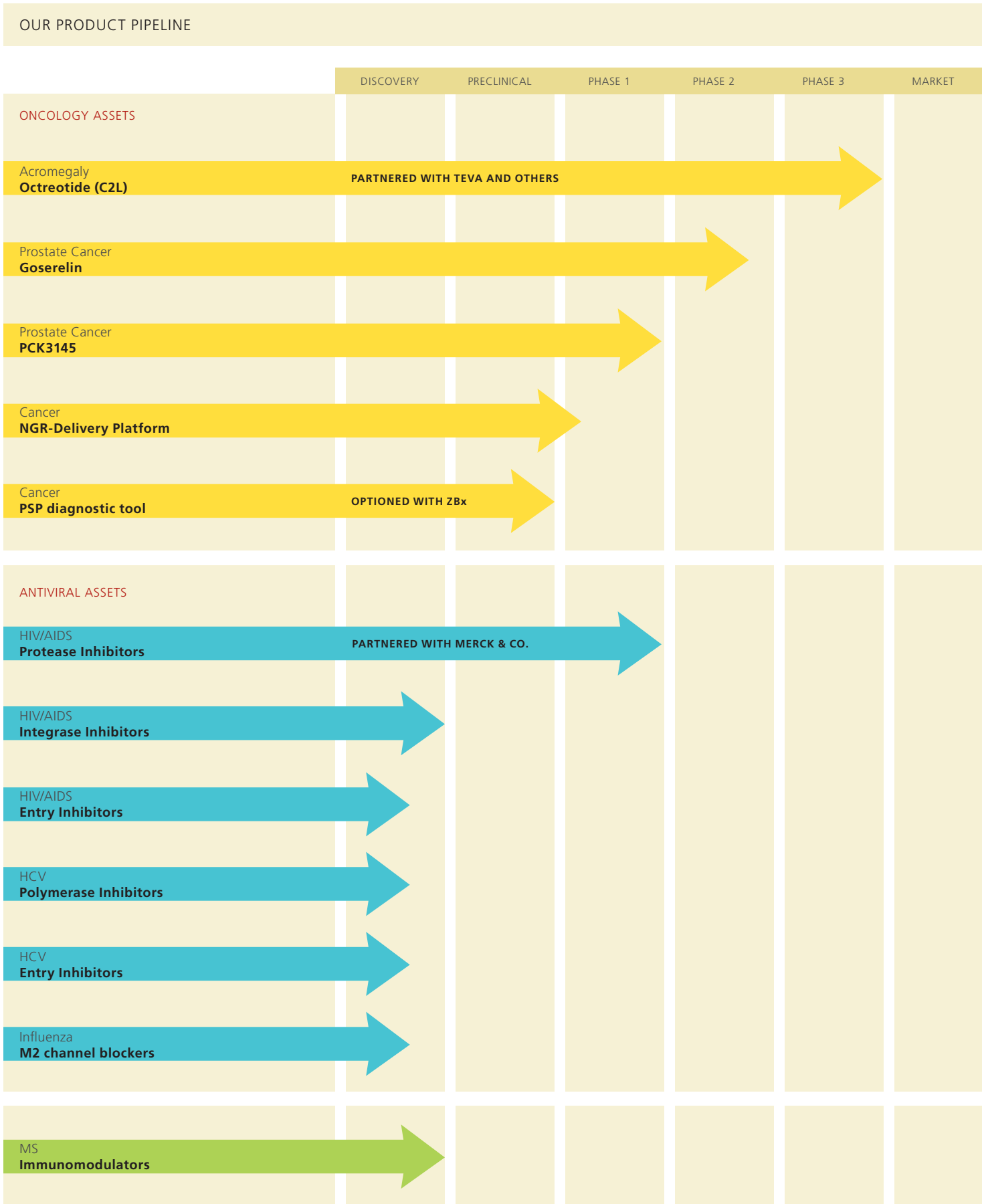
- Positive top-line results from second Phase III study support ability of C2L 30 mg administered every six weeks to potentially replace Sandostatin®LAR 30 mg every 4 weeks

##### **DECEMBER 2008**

- License option agreement grants ZBx Corp. worldwide rights to develop, manufacture and commercialize Ambrilia’s PSP94 technology for prostate cancer diagnosis
- Ambrilia takes additional cost-cutting actions and explores alternative strategic options to enhance shareholder value
- Request for Arbitration submitted to International Chamber of Commerce in order to resolve issues with Merck regarding development of PPL-100

##### **FEBRUARY 2009**

- Closure of Ambrilia Biopharma France S.A. subsidiary completed and Company operations consolidated at Montreal headquarters



# letter to shareholders

# going forward



After a promising first half, 2008 wound up being an extraordinarily difficult year as an unprecedented global economic crisis and a drying up of credit markets sideswiped the biotech sector. Small-cap companies like Ambrilia were particularly hard hit.

The financial and market turmoil struck at a crucial time for Ambrilia, as we were going forward with the step-by-step implementation of a new value-creation strategy. That strategy entailed monetizing non-core oncology assets, through the sale or licensing of these assets to third parties, in order to strengthen our financial position and allow us to focus on accelerated development of an antiviral portfolio that includes unique therapeutic drug candidates for HIV/AIDS, Hepatitis C and Influenza A.

To that end, we undertook a number of initiatives during the first half of 2008 to streamline the organization while pushing ahead with development work aimed at helping the Company extract maximum value from the sale or licensing of its oncology programs. We are also seeking other alternatives, including strategic partnership transactions and the sale or merger of Ambrilia.

## C2L OCTREOTIDE

Ambrilia's most advanced product is C2L octreotide (C2L), developed to become a therapeutic alternative to Novartis' Sandostatin® LAR (SLAR, long-acting release). SLAR is indicated to treat acromegaly and certain rare tumours. Acromegaly is a serious chronic condition related to a permanent hypersecretion of growth hormone by the pituitary gland. No generic alternatives to SLAR are currently on the market. Ambrilia's proprietary prolonged formulation releases the drug's active ingredient for a longer period than SLAR, allowing for an extended interval between injections — which should be an advantage for patients and the healthcare, once C2L is approved.

During 2008, we reported positive top line results of the two phase III studies (301 and 302), comparing the efficacy and safety of C2L administered every 6 weeks versus SLAR administered every 4 weeks in acromegaly patients. The results support the ability of C2L 30mg administered every 6 weeks to replace SLAR 30mg administered every 4 weeks, with similar clinical efficacy and no safety concerns. A third study (303) is now under way in the United States and Europe to evaluate the safety and efficacy of 30mg, 20 mg and 10 mg C2L doses for the same indication.

Another noteworthy development with regard to C2L octreotide involved the termination of a U.S. licensing agreement with Covidien Ltd. As a result, Ambrilia regained all license and marketing rights for its C2L formulation in the United States, which accounts for some 50% of the potential market. This enhances the prospective value to be derived from divesting this late-stage program. The termination agreement also provided for a one time payment of US\$1.2M to Ambrilia.

The C2L clinical development program continues to progress and the Company expects some regulatory filings to be initiated in 2009. Ambrilia now aims at extracting the maximum value from this asset in 2009.

## GOSERELIN FORMATION

The second drug being developed by Ambrilia is a three-month-release formulation of goserelin, a generic alternative to AstraZeneca's Zoladex®. Goserelin is indicated primarily for prostate cancer, but is also used for the treatment of certain gynaecological diseases. In July 2008, Ambrilia announced that it had initiated a clinical program of its 3-month depot formulation of goserelin, in prostate cancer patients. In September 2008, we also announced the successful development of a final one-month formulation of goserelin at our GMP (good manufacturing practice) facilities in Montreal. The availability of the 1-month and the 3-month forms provide for a complete and competitive product offering to potential partners.

Ambrilia's success in reaching those important milestones for the C2L octreotide and goserelin formulation programs — each targeting billion-dollar-plus markets — within established time lines enhances their potential value.

## NO-CORE PROGRAMS

I should note as well that we were able to validate the proof of concept with Ambrilia's targeted NGR-delivery technology for siRNA (small interfering RNA) or other anti-cancer agents. This technology is slated for divestment.

Our efforts to divest PCK3145, a patented, non-toxic, therapeutic peptide for the treatment of advanced metastatic prostate cancer are ongoing.

Finally, in December 2008, we entered into an exclusive license option agreement with ZBx Corporation, granting it the worldwide rights to develop, manufacture and commercialize Ambrilia's PSP94 technology for prostate cancer diagnosis.

## PPL-100

We were disappointed to announce late July that Merck & Co had decided to place a clinical hold on the development of our HIV protease inhibitor PPL-100, also known as MK-8122. In October 2006, Ambrilia entered into an exclusive licensing agreement granting Merck - through an affiliate - the worldwide rights to its HIV protease inhibitor program, including lead compound PPL-100.

At that time, Merck informed us that they decided to place a hold on the development of PPL-100/MK-8122 pending the outcome of additional work to evaluate other precursors of the drug (prodrugs), formulation options and back-up compounds.

Following many unsuccessful attempts to resolve matters with Merck, we came to the conclusion that seeking arbitration would be the most efficient way to reach a prompt resolution. Accordingly, on December 30, 2008, Ambrilia submitted a Request for Arbitration with the International Chamber of Commerce in order to resolve disputes, controversies and claims related to the October 2006 licensing agreement and to a November 2003 confidentiality agreement with Merck. Assuming the arbitration process takes a normal course, we anticipate resolution of this matter by the end of 2009.

#### ECONOMIC TURMOIL DEMANDED IMMEDIATE ACTION

Despite having made great strides in terms of increasing the potential value of the non-core assets we wished to divest, it became apparent by late September that the sudden precipitous decline of the global economy could well impact the timely sale of assets and make it difficult to finance a progressive acceleration in the development of Ambrilia's antiviral programs, as had been the plan.

With less than 12 months of cash on hand and facing an uncertain market environment, immediate action was required. On September 29, 2008, we reluctantly announced plans to put the Company's antiviral R&D activities on hold, prioritize the divestment of our C2L and goserelin clinical assets and implement stringent cost-reduction measures. Initial cost-cutting actions included a 33% decrease in headcount that impacted Ambrilia's basic research and preclinical team as well as administrative support functions.

In November and December of 2008, we announced additional cost-reduction measures to further preserve cash heading into 2009. Those actions included the closing of operations in France. By early February 2009, we had completed the closure of our Ambrilia Biopharma France S.A. subsidiary, which necessitated the termination of all the permanent employees based in France, including Dr. Bonabes de Rouge, the Senior Executive Vice-President & Chief Scientific Officer of Ambrilia and founder of one of our predecessor companies. Dr. de Rouge continues to contribute as a member of the Board of Directors. Ambrilia's operations are now concentrated at our Montreal headquarters with 14 employees, down from 48 at the end of 2007.

#### ACKNOWLEDGEMENTS

These were very difficult decisions and we deeply regret that deteriorating business conditions have caused us to slow our development program and reduce the size of our workforce. However, the reality is that there was no other alternative if we wished to preserve remaining jobs and maintain Ambrilia as a viable, value-creating enterprise going forward. We are grateful to employees past and present who share our vision to enhance the quality of existing medicines while developing novel therapeutics to address urgent unmet medical needs, and we appreciate the hard work and dedication demonstrated by our remaining staff in difficult circumstances.

In addition to Dr. de Rouge, two other former members of the senior management team left the Company over the past year — Dr. Jinzi Wu, who was Vice-President, Preclinical and Basic Research, and Julie M.

Thibodeau, our former Director of Communications. We are indebted to all three of these outstanding individuals for their contributions. I would also like to take this opportunity to thank the members of our Board for their support and counsel over the course of an unexpectedly challenging first year as CEO. Finally, I wish to express our gratitude to investors — including key shareholders — for continuing to show confidence in Ambrilia.

#### OUTLOOK

As 2009 unfolds, there is substantial doubt as to the Company's ability to continue as a going concern without having access to additional financial resources. It is therefore with an added sense of urgency that we continue pressing forward with our strategy to monetize assets — in particular our C2L octreotide program. At the same time, we are maintaining stringent controls on costs and limiting spending to the absolute minimum level required to sustain Ambrilia's operations. The Board has authorized management to broadly solicit proposals from third parties for transactions that might result in superior value for shareholders. A committee of the Board comprised of independent directors has been formed to consider and analyze all possible options and the Company has appointed Philadelphia-based Boenning & Scattergood as financial advisors in this process.

As this annual report was going to press, Ambrilia had not entered into any agreements involving the disposition of assets or businesses. However, we are engaged in on-going talks with potential partners regarding a number of strategic alternatives, including divestment of and/or strategic-partnership transactions involving individual technologies or classes of technologies as well as the potential sale or merger of the entire Company.



**Philippe Calais, Ph.D., Pharm.**  
President and Chief Executive Officer

# oncology assets going ahead

## **The Value Creation Opportunity:**

**An improved formulation of the \$US1.0 billion worldwide market leading octreotide product**

OCTREOTIDE (C2L): PHASE III  
ACROMEGALY

Acromegaly is a rare and serious condition related to the hypersecretion of growth hormone by the pituitary gland, generally of tumoral origin. This causes an uncontrolled growth of organs, debilitating symptoms and a shorter life expectancy. Pharmacotherapy with somatostatin analogs is one of the treatment options, a life-long treatment with an acceptable tolerability. Novartis' Sandostatin® (octreotide) is the market leader with reported 2007 worldwide sales of \$US1-billion (+7% y-y growth). Its efficacy is established for treating acromegaly. The yearly treatment with the long-acting release (LAR) formulation of the product, which consists of intramuscular injections every four weeks, is costly. Difficult reconstitution prior to injection is also an issue. Ambrilia has developed an improved, proprietary prolonged release formulation of Octreotide (C2L) that is easier to reconstitute and administer and could be the first therapeutic alternative to the long-acting formulation of the original product. Positive results from two Phase III comparative studies support the ability of C2L 30 mg to be administered every six weeks and could replace Sandostatin®LAR 30 mg every four weeks with similar clinical benefit profile of adverse effects.

## **The Value Creation Opportunity:**

**No generic version of the current \$US1.1 billion European market leader**

GOSERELIN: PHASE I/II  
PROSTATE CANCER

Prostate cancer is one of the most common cancers worldwide and the leading cancer in men in Europe and North America. Age continues to be the major risk factor for prostate cancer. Fortunately, systematic screening and better diagnostic and prognostic tools have improved curing rates and management of the disease. Hormonal therapy with Luteinizing Hormone- Releasing Hormone (LHRH) analogs is one of the standard treatments for prostate cancer, blocking the hormones that can cause the cancer to grow. The market leading LHRH analog in Europe is AstraZeneca's Zoladex® (goserelin) with reported 2007 worldwide sales of \$US1.1B (+10% y-y growth). Ambrilia has developed a novel Goserelin formulation of the three-month release version of the original product. Currently there is no three-month generic of AstraZeneca Zoladex® commercially available. Ambrilia has also developed the one-month goserelin formulation, thereby completing its product offering with both forms.

## **The Value Creation Opportunity:**

**The gap in prostate cancer hormone-resistant treatment**

PCK3145: PHASE I/II  
HORMONE-RESISTANT PROSTATE CANCER

While most prostate cancer patients respond to hormonal therapy, eventually they will become resistant. Advanced prostate cancer is an incurable disease. For those patients with advanced hormone-resistant prostate cancer, the prognosis is poor with an average survival rate of only two years. While some recent studies have shown that chemotherapy may extend the life span of some patients, the survival advantage and tolerability are still very low. To date, only chemotherapy based with Sanofi-Aventis' Taxotere® (docetaxel) has been approved as the first-line standard of care for these patients. Aventis has reported 2007 worldwide sales of €1.87B (+11.9% y-y growth) for Taxotere®. There is a significant unmet need to develop better treatment alternatives for these patients, offering improved efficacy and tolerability. Ambrilia has developed a non-toxic, patented therapeutic peptide, PCK3145, with a dual mechanism of action to restrict disease development. The Company has already conducted two Phase I/II clinical trials, in the U.K. and in the U.S. Data have shown PCK3145 to be safe and well tolerated with preliminary signs of clinical benefits, primarily in terms of disease stabilization in advanced hormone-resistant prostate cancer patients.

## **The Value Creation Opportunity:**

**The delivery hurdle within the potential multi-billion dollar RNAi market**

NGR-DELIVERY PLATFORM: PRECLINICAL  
CANCER

RNA interference (RNAi) is a natural process of gene silencing involving certain fragments of double stranded RNA. Inside the cell, these fragments can be used in a sequence specific manner in order to recognize and destroy complementary RNA, silencing the gene. Cancer often involves mutant genes promoting uncontrolled cell growth. In the past years, a number of cancer-causing genes have been silenced with RNAi, showing the potential for therapeutic applications in humans. One of the technology's major hurdles is efficient delivery, getting a sufficient amount of the desired siRNA into the targeted cells. Ambrilia has developed a targeted delivery technology that uses a proprietary peptide coupled with a carrier. This peptide specifically binds to a receptor expressed by many tumor cells, which in turn triggers internalization of the carrier's load into the cell. The first proof-of-concept was demonstrated with a cytotoxic agent in both *in-vitro* and *in-vivo* animal models. The use of this platform was further demonstrated in the delivery of siRNA (small interfering RNA)/RNAi with *in-vitro* and *in-vivo* animal data supporting, not only delivery, but also gene silencing and apoptosis, thereby providing the potential to overcome several key challenges in the ongoing siRNA/RNAi developments.

**The Value Creation Opportunity in HIV:**

**A \$US8.5 billion<sup>(1)</sup> market in need of treatments offering greater tolerability and convenience, and distinct resistance profiles**

PROTEASE INHIBITORS: LICENSED TO MERCK & CO. (PHASE I)  
HIV/AIDS

In October 2006, Ambrilia concluded a \$US232-million partnership agreement with Merck & Co. for its novel HIV protease inhibitor (PPL-100) and related compounds. PPL-100, now renamed MK-8122, has the potential of being a best-in-class HIV protease inhibitor. To this date, all approved protease inhibitors require ritonavir (another protease inhibitor) to boost their availability in the system but which at the same time increases the number of adverse events. Also, most of them have low genetic barriers, making it easier for the virus to offer resistance, and medium to high levels of cross-resistance. MK-8122 was shown to possess key attributes such as a high genetic barrier, a low cross-resistance profile and more importantly, does not require ritonavir boosting. In July of 2008, Merck placed a clinical-development hold on MK-8122 pending the outcome of additional work to evaluate other precursors of the drug (prodrugs), formulation options and back-up compounds. Ambrilia has submitted a Request for Arbitration to the International Chamber of Commerce with the aim of resolving issues related to the partnership.

INTEGRASE INHIBITORS: DISCOVERY  
HIV/AIDS

Integrase inhibitors emerge as an exciting new class of HIV drugs. They block the action of integrase, an enzyme that integrates genetic material from the virus into a host cell for replication. Approved by the FDA on October 12, 2007, Merck & Co.'s Isentress® (raltegravir) is the first-in-class integrase inhibitor. While the product has shown a favorable safety profile and good clinical efficacy, viral resistance and cross-resistance are already issues. Furthermore, compounds in clinical development appear to have similar modes of action or resistance profiles, and some require ritonavir boosting. Ambrilia has developed a novel series of pyrazolopyridine compounds with significant inhibition against HIV integrase strand transfer activity. In addition to these compounds, the Company is working as well on another novel series of HIV integrase inhibitors.

**The Value Creation Opportunity in HCV:**

**A rapidly growing \$US3.8 billion<sup>(1)</sup> market with a sub-optimal standard of care and no approved small molecule inhibitors to date**

POLYMERASE INHIBITORS: DISCOVERY  
HCV

Hepatitis C is a blood-borne disease caused by Hepatitis C virus (HCV) infecting the liver. Hepatitis or liver inflammation is often asymptomatic, but ensuing chronic hepatitis can result later in cirrhosis and liver cancer. According to the American Liver Foundation, more than four million Americans have been infected with HCV; responsible for 8,000-10,000 deaths annually. Between 60 and 85% of patients will develop chronic hepatitis, a life-long disease unless treated successfully with antivirals. Today, the standard of care is a combination of pegylated interferon and ribavirin. Unfortunately, because of contraindications and toxicities of these drugs some patients do not undergo treatment. For those who get treated, the success rate is only about 50%. Small molecule inhibitors in development target the HCV polymerase and protease enzymes, both involved in viral replication. To this date very few are in late-stage clinical development and a large number have failed due to safety or efficacy issues. Ambrilia has identified a series of potent polymerase inhibitors.

ENTRY INHIBITORS: DISCOVERY  
HIV/AIDS

Entry inhibitors are a class of antiretroviral drugs which target key proteins involved in the HIV entry process, interfering with the virus binding, fusion and entry to a host cell. Today, only enfuvirtide (Roche's Fuzeon®), a fusion inhibitor, and maraviroc (Pfizer's Selzentry®), a CCR5 co-receptor antagonist, are approved within this class with significant limitations in terms of safety and efficacy. Ambrilia has identified compounds which demonstrate a high potency and specificity against HIV entry.

(1) B.McCarthy (2007) Nature Biotechnology, Vol. 25, pp. 1390-1393

IMMUNO MODULATORS: DISCOVERY  
NEUROLOGICAL AND AUTOIMMUNE DISORDERS

OSK and MTX are Ambrilia's two lead ion-channel modulators in development for the treatment of neurological disorders and autoimmune diseases. Both OSK and MTX compounds are considered the most potent in their class. Preliminary in-vivo animal data demonstrates a potentially positive therapeutic effect for OSK in Multiple Sclerosis.

In addition Ambrilia also has an early stage program targeting Influenza A.

## CORPORATE GOVERNANCE

Ambrilia Biopharma is committed to follow and maintain high standards of Corporate Governance. The Board of Directors of Ambrilia believes that good governance practices protect long-term shareholder value and ensures that the Company conducts its activities and operations with integrity and in an ethical manner, geared towards shareholders' best interest. The Company aligns with the recommendations of the Toronto Stock Exchange's Corporate Governance Guidelines as detailed in its Statement of Corporate Governance Practice (contained in the Management's Proxy Circular). Additional information, including Ambrilia's financial reports and other regulatory filings can be found in the Investor Section of the Company's web site at [www.ambrilia.com](http://www.ambrilia.com) as well as on the System for Electronic Documents Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com).

## BOARD OF DIRECTORS

### **Philippe Calais, Ph.D., Pharm.**

President and Chief Executive Officer  
Ambrilia Biopharma Inc.

### **Bonabes de Rougé, M.D.**

Former Senior Executive Vice-President and Chief Scientific Officer  
Ambrilia Biopharma Inc.

### **François Lombard, Ph.D.**

Chief Executive Officer  
Turenne Capital Partenaires

### **Frédéric Porte (Chairman of the Board)**

President  
Médipress Management Inc.  
Venture Partner  
Genesys Capital Partner

### **Paul-Henry Schmelck, M.D.**

Director, Investments  
OTC Asset Management

### **Jean-Paul St-Pierre, M.D.**

Biotechnology Consultant  
Practicing Physician

### **Philip Tabbiner, Ph.D.**

President and General Manager  
K-12 Learning and Development, Educational Testing Systems

### **Luc Tanguay, M.Sc., CFA**

Senior Executive Vice-President and Chief Financial Officer  
Theratechnologies Inc.

## SHAREHOLDER INFORMATION

### **Head Office**

Ambrilia Biopharma Inc.  
1000 chemin du Golf  
Verdun, Quebec H3E 1H4  
Tel: 514 751-2003  
Fax: 514 751-2502  
Web site: [www.ambrilia.com](http://www.ambrilia.com)

### **Stock Listing**

Listing: Toronto Stock Exchange  
Symbol: AMB

### **Transfer Agent and Registrar**

Computershare Investor Services  
1500 University Street, 7th floor  
Montréal, Quebec H3A 3S8  
Tel: 514 982-7888

### **Auditors**

Ernst & Young LLP

### **Corporate Counsel**

Fasken Martineau DuMoulin LLP

### **Annual General Meeting of Shareholders**

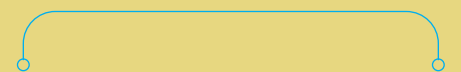
The 2008 Annual General Meeting of Shareholders will be held on Tuesday, June 30, 2009, at 10:30 a.m. ET at:

Centre Mont-Royal  
2200 Mansfield Street  
Montréal, Quebec H3A 3R8  
Tel: 514 844-2000

### **Investor Information**

Philippe Calais, Ph.D., Pharm.  
President and Chief Executive Officer  
Tel: 514 751-2003 ext. 235  
e-mail: [pcalais@ambrilia.com](mailto:pcalais@ambrilia.com)  
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keep on going





management's  
discussion and  
analysis of financial  
condition and  
results of operations

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consolidated  
financial  
statements

ambrilia biopharma Inc.  
december 31, 2008

# management's discussion and analysis of financial condition and results of operations

ambrilia biopharma Inc.  
december 31, 2008

The following discussion and analysis should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2008 and the related notes therein, 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 as at March 25, 2009. Additional information relating to the Company, including the Company's Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## FORWARD-LOOKING STATEMENTS

Except for the historical information, matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations of Ambrilia Biopharma Inc. ("Ambrilia") may constitute forward-looking statements that are subject to certain risks and uncertainties that could cause actual results to differ materially from any future results, performance or achievements expressed or implied by such statements. Statements that are not historical facts, including statements preceded by, followed by, or that include words such as "believes", "anticipates", "intends", "plans", "expects", "estimates", "should" or the negative of these words or variations of them or similar terminology may constitute forward-looking statements. There is a significant risk that predictions and other forward looking statements will not prove to be accurate. Readers are cautioned not to place undue reliance on these forward-looking statements, as they involve risks and uncertainties, which could make actual results differ materially from those currently anticipated. Such risks and uncertainties include the risks disclosed in "Risk Factors" and the effect of misjudgments in the course of preparing forward-looking statements. Such statements are also based on various assumptions, including the successful and timely completion of clinical studies on Ambrilia's products demonstrating efficacy and safety for human use, their successful commercialization within the forecasted timelines and the attainment of the forecasted milestone payments and other revenues. While Ambrilia anticipates that subsequent events and developments may cause Ambrilia's views to change, Ambrilia specifically disclaims any obligation to update these forward-looking statements, unless obliged to do so by applicable securities legislation.

## OVERVIEW AND OUTLOOK

Ambrilia Biopharma Inc. ("Ambrilia" or "the Company") is a publicly-traded (TSX:AMB) biotechnology company engaged in the discovery and development of small molecules and peptides to treat infectious diseases and cancer.

As at December 31, 2008, there was substantial doubt as to the Company's ability to continue as a going concern without having access to additional financial resources. (See "Risk Factors" – "Going Concern Uncertainty").

Ambrilia's pipeline includes: C2L octreotide, a proprietary improved and prolonged release formulation of an existing drug to treat acromegaly; a new 3-month release formulation as well as a new 1-month release formulation of goserelin to treat prostate cancer; PCK3145, a therapeutic non-toxic peptide for the treatment of hormone-resistant prostate cancer; NGR-Delivery Technology (previously referred to as the TVT Technology), a targeted delivery technology for cancer. Ambrilia also has a novel biomarker for the diagnostic and prognostic of prostate cancer, PSP. In October 2006, Ambrilia granted to an affiliate of Merck & Co., Inc., exclusive worldwide rights to its HIV protease inhibitor program, including lead-compound PPL-100 (renamed MK-8122). The antiviral pipeline is comprised of HIV protease, integrase and entry inhibitors, HCV inhibitors and anti-influenza compounds. On September 29, 2008, Ambrilia announced cost-cutting actions which resulted in a hold on its antiviral research and development activities.

### Octreotide

Ambrilia had previously reported the results from its Phase III efficacy and safety study 301 where C2L was administered every 6 weeks and compared to Sandostatin LAR administered every 4 weeks, for a duration of 84 days. Thereafter all patients were administered C2L every 6 weeks for a further duration of 84 days.

Ambrilia reported the completion of a 24 weeks extension of its phase III study ("study 302") of C2L, the Company's long acting 30 mg Octreotide dosage form; the results support the ability of C2L 30 mg administered every six weeks to replace Sandostatin® LAR 30 mg administered every four weeks.

The other phase III study of C2L ("study 303"), which is designed to evaluate the 20 mg and 10 mg dosage forms, is proceeding and involves clinical centers in Europe and in the USA.

On May 13, 2008, the Company entered into an agreement for the termination of the U.S. licensing agreement with Covidien Ltd., thereby regaining all license and marketing rights for its C2L octreotide formulation in the U.S. The termination agreement also provided for a one time payment of US\$1.2 million to Ambrilia.

The Company depends on its commercial partners to file for marketing authorization. The C2L clinical development program continues to progress and the Company expects some regulatory filings to be initiated in 2009. Ambrilia now aims at extracting the maximum value from this asset in 2009.

### **Goserelin**

Ambrilia announced in July 2008 that it had initiated a clinical program of its 3-month depot formulation of Goserelin in prostate cancer patients.

In parallel, the Company succeeded in developing a 1-month formulation of Goserelin, intended for the treatment of prostate cancer and several gynaecological indications.

### **Non-core programs**

In December 2008, the Company entered into a 9-month exclusive license option agreement with ZBx Corporation granting ZBx the worldwide rights to develop, manufacture and commercialize PSP94 technology. At any time during this evaluation period ZBx is entitled to exercise its option upon which Ambrilia would be eligible to receive up to a total of US\$ 3.62 million with the achievement of development and commercialization milestones, plus royalties on sales as well as a percentage share from any sublicenses. ZBx will cover all costs associated with the evaluation period and future costs associated with the further development, manufacturing and commercialization.

Divestment discussions continue to also monetize the following oncology assets:

PCK3145, Ambrilia's non-toxic therapeutic peptide for the treatment of advanced metastatic prostate cancer. The mechanism of action suggests that PCK3145 exhibits both anti-metastatic and anti-angiogenic properties. In April 2007, Ambrilia reported the results of a Phase I/II study performed at Memorial Sloan-Kettering Cancer Centre in New York in which PCK3145 showed a favorable safety profile and clinically relevant benefits primarily in terms of disease stabilization were observed in several patients.

NGR- Directed Delivery platform, Ambrilia's means to specifically deliver a therapeutic drug to tumours. The first proof-of-concept was demonstrated with a cytotoxic agent in both *in-vitro* and *in-vivo* animal models.

### **Anti-virals**

Ambrilia's virology research programs have provisionally been put on hold, while the Company implements its divestment strategy.

Ambrilia's antiviral portfolio is comprised of small molecules and peptides with activity against HIV integrase, HIV entry, HCV polymerase and HCV entry.

In addition Ambrilia also has an early stage program targeting Influenza A.

On December 30, 2008, Ambrilia announced that it has submitted a Request for Arbitration with the International Chamber of Commerce (ICC) to resolve disputes, controversies and claims related to a November 14, 2003 Confidentiality Agreement and an October 12, 2006 Exclusive License Agreement between Ambrilia and Merck & Co., Inc. and Merck Sharpe & Dohme Research Ltd (collectively, "Merck") respectively and certain Ambrilia patent and other rights. Following

many attempts at resolution with Merck, Ambrilia came to the conclusion that seeking arbitration was the most efficient way to reach a prompt resolution to the situation.

### **Acquisitions and Divestitures**

The Company has incurred substantial losses since its inception, due primarily to its expenditures for research and development activities. It may incur further losses during the next few years resulting from the continuation of its ongoing clinical trials and pre-clinical development activities. However, at the end of 2008, the Board of Directors has approved a strategic review that could have a significant impact on the level of future losses. This review explores all strategic options available to the Company to protect and enhance shareholder value including the divestment, strategic partnership transactions or licensing of the Company's technologies, and the sale or merger of the Company. The Board of Directors has established a committee of independent directors to consider and analyze all possible options. There can be no assurance that the review will result in any specific strategic or financial transactions and no timetable has been set for its completion.

During 2008, the Company increased its ownership in Ambrilia Biopharma France S.A. ("Ambrilia France") to 100% by acquiring an additional 2.82% of the outstanding shares through the exercise of its option under a share exchange agreement on March 3, 2008 and acquiring the remaining 0.07% on November 7, 2008 for a cash purchase price of \$75,800.

Under an Asset Sale & Purchase Agreement dated December 14, 2007, the Company sold its ANsA technology, which it had written off in 2004, for total proceeds of US \$1,960,000, all of which is contingent upon the achievement of certain development milestones, together with a share of royalties or other related amounts to be received by the purchaser of the ANsA technology.

### **CRITICAL ACCOUNTING 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 the more critical estimates used are as follows:

#### **Investment Tax Credits**

The Company incurred research and development expenditures that are eligible for investment tax credits. The investment tax credits, which are recorded as a reduction of research and development expenses, amounted to \$1,294,121 in 2008 (2007 - \$845,632) and are based on management's estimates of amounts that will be recovered. However, these amounts are subject to audit by taxation authorities. Management considers that the amounts recorded have been conservatively estimated.

#### **Impairment of Long-lived Assets**

When the carrying value of a long-lived amortizable asset is more than its net recoverable value as determined on an undiscounted basis, an impairment loss is recognized. The impairment loss is recognized to the extent that the asset's fair value measured on a discounted expected cash flow basis over its life is below its carrying value. Management must estimate the cash flows that can be derived from the Company's long-lived assets to assess impairment. Impairment write-downs totaling \$19,064,975 were recorded in 2008 to reflect the fair value of certain of its intellectual property assets. No impairments were identified in 2007.

### **Stock-based Compensation**

The Company also makes accounting estimates of the fair value of stock options granted to employees, directors and consultants and of warrants issued to purchase common shares of the Company. Management is required to make estimates of volatility, expected life and dividend yield. As at December 31, 2008, a total of 1,593,436 stock options were outstanding, of which 1,235,640 were exercisable at that date. In addition to the above, 424,219 options were granted to employees on August 11, 2008 conditional upon obtaining shareholders' approval. Also, 15,877,037 common shares were reserved for issuance on the exercise of warrants. The warrants, net of issue costs, were recorded at \$8,610,715.

### **Valuation Allowance for Future Tax Assets**

A valuation allowance has been recorded on future tax assets primarily related to operating losses and research and development expenditures carry forwards. We have assumed that the related tax benefits are not likely to be realized, based on the Company's historical results and estimated future taxable income and tax planning strategies. The implementation of tax planning strategies or the generation of future taxable income could result in the recognition of some portion or all of these carry forwards as soon as the Company has a history of net income, which could result in a material increase in the results of operations through the recovery of future income taxes.

## **RESULTS OF OPERATIONS**

### **Quarter ended December 31, 2008 compared with the quarter ended December 31, 2007**

The net loss for the fourth quarter of 2008 was \$19,715,286 or \$0.41 per common share, compared with \$6,265,104 or \$0.15 per common share for the same quarter last year.

### **Revenues**

Revenues for the fourth quarter of 2008 amounted to \$73,366, compared with \$242,979 in the corresponding quarter in 2007. The lower level of revenues in the 2008 period resulted primarily from the decrease in interest income earned as a result of the reduced average levels of cash and lower interest rates compared to the fourth quarter of 2007 .

### **Research and Development Expenses**

Research and development expenses for the fourth quarter of 2008 amounted to \$2,287,946, compared with \$2,857,867 in same quarter in 2007. The decrease of \$569,921 reflected a decrease in spending on Integrase and lower R&D general expenses following the restructuring which occurred at the end of September 2008. Research and development tax credits were \$438,279 in the last quarter of 2008, compared with \$249,266 in the corresponding quarter last year. The increase reflects primarily the higher rate of tax credits available in France commencing January 1, 2008.

### **General and Administrative Expenses**

General and administrative expenses for the fourth quarter of 2008 were \$1,540,507, an increase of \$25,581 over the total of \$1,514,926 incurred in the final quarter of 2007. The increase resulted primarily from a provision for a lawsuit against the Company, partially offset by reduced compensation and other employee-related costs, reflecting the reduced staffing levels.

### **Business Development Expenses**

Business development expenses amounted to \$75,784 in the fourth quarter of 2008, compared to \$182,674 for the same quarter last year. The decrease of \$106,890 was primarily due to lower compensation costs in the current quarter. These amounts are segregated on the statement of operations for the first time in 2008 and were previously included with research and development and general and administrative expenses.

### **Amortization Expense**

Amortization expense amounted to \$2,390,396 in the final quarter of 2008, compared with \$2,390,770 in the same quarter in 2007.

### **Interest on Long-term Liabilities**

Interest expense on long-term liabilities for the fourth quarter of 2008 amounted to \$224,005, compared with \$267,499 in the same quarter last year. The decrease resulted from the lower level of interest rates in the current quarter.

### **Restructuring Charges**

Restructuring charges in the fourth quarter of 2008 amounted to \$1,364,055 and related primarily to the severance costs associated with the closure of the Company's French subsidiary which was completed in the first quarter of 2009. No restructuring charges were incurred in the fourth quarter of 2007.

### **Write-down of Carrying Value of Intellectual Property**

A write-down of the carrying value of intellectual property of \$15,369,258 was recorded in the fourth quarter of 2008. This resulted from a review of the status of the Company's ongoing divesting activities, which indicated that an additional write-down was required to reflect a reduction in the fair value of certain of the Company's intellectual property, determined on a discounted expected cash flow basis.

### **Future Income Tax Recovery**

The future income tax recovery for the fourth quarter of 2008 was \$3,142,138 which was supplemented by a foreign exchange gain of \$71,755 relating to the future income tax liability. These amounts compared to a recovery of \$891,085 for the corresponding quarter in 2007, which was partially offset by a foreign exchange loss of \$288,979. As at December 31, 2008, the future income tax liability on the consolidated balance sheet is eliminated, as the tax benefit of the tax losses available in France now more than offsets the future income tax liability that remains following the acquisition of Ambrilia Biopharma France S.A.

### **Year ended December 31, 2008 compared with the year ended December 31, 2007**

The net loss for the year ended December 31, 2008 amounted to \$39,807,031 or \$0.83 per common share, compared with a net loss of \$25,277,859 or \$0.75 per common share for the year ended December 31, 2007.

### **Revenues**

Revenues for 2008 amounted to \$4,154,588, compared with \$837,009 in 2007. The higher level of revenues in 2008 resulted primarily from the payment received from Mallinckrodt Inc., a Covidien company, of \$1.2 million under the May 13, 2008 termination agreement whereby Mallinckrodt Inc. relinquished all license and marketing rights to C2L octreotide. In addition, an amount of \$2.4 million relating to previous milestones received from Mallinckrodt Inc. which had been included in deferred revenue was recognized as license revenue in the current year. Except for 2006 and 2008, when significant amounts were received from licensing and license termination transactions, revenues were earned primarily from interest on available cash and short-term investments. We expect to continue to receive such interest revenues.

### **Research and Development Expenses**

Research and development expenses for 2008 amounted to \$10,772,560, compared with \$10,250,484 in 2007. The increase of \$522,076 or 5% from 2007 reflected primarily an increase of \$1.0 million for C2L, Goserelin and antivirals, partially offset by decreased spending on non core oncology technologies of \$0.3 million and lower R&D general expenses. Research and development tax credits were \$1,294,121 in 2008, compared with \$845,632 in 2007. The increase reflects primarily the higher rate of tax credits available in France commencing January 1, 2008.

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. In 2008, fees paid to external service providers were primarily related to clinical development of C2L and Goserelin.

We expect our future research and development expenses to continue to be significant as we continue with the clinical development of C2L and Goserelin. However, the Company is presently reviewing strategic alternatives, including the divestment, strategic partnership transactions or licensing of the company's technologies and the sale or merger of the Company. The result of this review could impact the level of future R&D activities.

In relation to major projects underway at the end of 2008 discussed in the "Overview and Outlook" section, for C2L octreotide, a long term open label extension study evaluating safety and efficacy in acromegaly (Study 302) and an open-label multicenter study evaluating the safety and efficacy of the 10, 20 and 30 mg doses in the same indication (Study 303) are ongoing. Spending for clinical development of C2L in 2008 amounted to approximately \$ 3.4 million and an additional \$1.6 million is expected to be incurred in 2009. For Goserelin, costs incurred in 2008 amounted to approximately \$0.8 million, with further spending of approximately \$ 0.4 million projected for 2009.

The above amounts do not include related salary costs and are expenses expected in a context of a going concern. The projected level of research and development expenditures could be reduced, depending on the outcome of the various projects, the financial situation of the Company and the decisions taken following the strategic review of possible options for the Company.

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

General and administrative expenses for 2008 were \$5,772,494, a decrease of \$1,593,132 from the total of \$7,365,626 incurred in 2007. The decrease resulted primarily from lower compensation costs of \$1.7 million. Compensation costs in 2007 included additional payments to certain outside directors totaling \$0.3 million as compensation for their increased involvement in management activities in the absence of a President & CEO for most of the year.

#### **Business Development Expenses**

Business development expenses amounted to \$864,833 for 2008, compared to \$956,333 for 2007. The decrease of \$91,500 was primarily due to lower compensation costs in 2008. These amounts are segregated on the statement of operations for the first time in 2008 and were previously included with research and development and general and administrative expenses.

#### **Amortization Expense**

Amortization expense amounted to \$9,523,890 in 2008, compared with \$9,047,774 in 2007. The increase reflected primarily the impact of amortization on intellectual property resulting from the acquisition of additional shares of Ambrilia France during 2007 and 2008.

#### **Interest on Long-term Liabilities**

Interest expense on long-term liabilities for 2008 amounted to \$953,465, compared with \$1,055,932 in 2007. The decrease resulted from the reduced interest on the Biolevier loan as a result of the lower average level of interest rates prevailing in 2008.

#### **Restructuring Charges**

Restructuring charges in 2008 amounted to \$2,275,330, compared with \$208,341 in 2007. The 2008 charges reflected four separate actions. The first was a decision by the Company to streamline its activities, which resulted in the departure of the former Executive Vice-President, Business Development, Licensing and IP in February 2008. This was followed in September 2008 by cost-cutting actions which resulted in a 33% reduction in headcount. In December 2008, the Company announced that it had taken additional cost-cutting actions, resulting in a further decrease in headcount. Also, in November, 2008, the Company announced that it intended to initiate a plan aimed at significantly reducing its activities in France. On February 4, 2009, the Company completed the process resulting in the layoff of all the permanent employees based in France. All related severance costs have been recorded in the current period, except for an additional amount of approximately \$398,000 related to the severance costs in France which will be recorded only in the first quarter of 2009 to conform with Canadian reporting requirements.

#### **Write-down of Carrying Value of Intellectual Property**

Write-downs of the carrying value of intellectual property of \$19,064,975 were recorded in 2008. These resulted from reviews carried out at both September 30 and December 31, 2008, which indicated that the write-downs were required to reflect a reduction in the fair value of certain of the Company's intellectual property.

#### **Future Income Tax Recovery**

As a consequence of the intellectual property arising on the acquisition of Ambrilia France, a future income tax liability of \$9,787,526 was recorded during 2006, with additional amounts of \$315,275 and \$604,356 added in 2008 and 2007 respectively, primarily through the exercise of acquisition warrants to acquire additional shares of Ambrilia France. This future income tax liability is being drawn down over a term of up to the 7-year period during which the intellectual property is being amortized. This resulted in a future income tax recovery of \$4,663,037 in 2008, compared with a recovery of \$2,271,909 in 2007. The 2007 amount was increased by a foreign exchange gain relating to the future income tax liability of \$279,780. As at December 31, 2008, the future income tax liability on the consolidated balance sheet is eliminated, as the tax benefit of the tax losses available in France now more than offsets the future income tax liability that remains following the acquisition of Ambrilia Biopharma France S.A.

## CASH FLOWS

### Quarter ended December 31, 2008 compared with the quarter ended December 31, 2007

Cash and cash equivalents increased by \$2,585,221 in the current quarter, compared with an increase of \$1,559,770 in the same quarter last year. Excluding amounts invested in and maturities of short-term investments, net cash decreased in the fourth quarter by \$3,357,644, compared with an increase of \$12,732,849 in the fourth quarter of 2007.

Operating activities utilized \$3,238,346 in the current quarter compared to \$4,206,855 in the corresponding quarter last year. Net purchases of intellectual property and property, plant and equipment amounted to \$43,793 in the current quarter, compared to the total of \$196,221 in the fourth quarter last year. The remaining minority shares of Ambrilia France were purchased for \$75,800 during 2008. Net proceeds of financing activities in the current quarter amounted to \$295, while in the fourth quarter of 2007 \$17,135,926 was generated.

### Year ended December 31, 2008 compared with the year ended December 31, 2007

Cash and cash equivalents decreased by \$2,460,133 in 2008, compared with an increase of \$7,639,443 in the prior year. The 2008 amount includes a cash contribution of \$14,604,624 from net maturities of short-term investments, compared with \$4,599,126 in 2007. Excluding these contributions from short-term investments, net cash decreased by \$17,064,757 in 2008, compared with an increase of \$3,040,317 in 2007. In 2008, operating activities utilized \$16,616,902 of cash, whereas 2007 operating activities utilized \$17,785,616 of cash, a favourable year-over-year change of \$1,168,714. Two financing transactions took place in the 2007, with net proceeds of \$22,796,800. There were no financing transactions in 2008. Net purchases of intellectual property and property, plant and equipment amounted to \$372,350 in the current year, a decrease of \$832,126 from the amount of \$1,204,476 in 2007. Also, an Ambrilia France loan of \$766,391 was repaid in 2007.

## 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, loans, scientific research investment tax credits, interest income and amounts received under licensing agreements for certain of its products.

Cash and cash equivalents and short-term investments at December 31, 2008 totalled \$8,335,164, compared with \$25,399,921 at December 31, 2007, a decrease of \$17,064,757 in 2008. An amount of \$16,616,902 was utilized to finance operating activities including an increase of \$1,746,598 in non-cash working capital, resulting primarily from an increase of \$2,414,842 in deferred license revenues and a decrease of \$1,776,311 in investment tax credits recoverable, partially offset by an increase of \$1,464,032 in accounts payable and accrued liabilities and decreases of \$814,712 in other long-term assets and \$173,046 in accounts receivable. The increase in deferred license revenues resulted from the termination agreement with Mallinckrodt Inc. relating to C2L octreotide discussed under "Revenues" above.

Financing activities generated cash flow of \$295 in 2008 and \$22,030,409 during 2007, when a total of \$22,796,800 was generated from two equity issues, after cash expenses of \$1,739,327. Also, an Ambrilia France loan of \$766,391 was repaid in 2007.

Investing activities utilized \$448,150 of cash, excluding amounts relating to short-term investments. An amount of \$215,133 was utilized for the purchase of intellectual property and \$157,217 for net additions to property, plant and equipment. An amount of \$75,800 was utilized to acquire the remaining outstanding shares of Ambrilia France S.A.

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 June 2008, the Company had elected to pay the interest in shares. However, the maximum number of common shares issuable for this purpose is limited to a number approved by the Toronto Stock Exchange, and consequently interest subsequent to the June 2008 amount must be paid in cash.

Interest on the Biolevier loan balance of \$8,927,466 is at prime rate plus 3% and subsequent to November 19, 2006, is payable in cash. The loan is reported on the balance sheet at December 31, 2008 net of related expenses at \$8,322,914 and is being accreted to the full amount due of \$8,927,466 over the remaining term of the loan.

During 2008, general and administrative, business development and net research and development expenses amounted to \$16.1 million, for an average of \$1.3 million per month. During the second half of 2008, the Company announced a series of cost-cutting actions resulting in reduction in cash consumption and a decrease in headcount to preserve its cash into 2009. The Company is also reviewing strategic alternatives that include the divestment, strategic partnership transactions or licensing of the Company's technologies, and the sale or merger of the Company. There can be no assurance that the review will result in any specific strategic or financial transactions and no timetable has been set for its completion. Depending upon the success of this review, the Company may not have sufficient cash to support its activities for the next 12 months without having access to additional financial resources, which could be difficult to obtain in the short-term due to the ongoing crisis in financial markets. The Company may have to undertake further reductions in its operations.

#### SELECTED ANNUAL INFORMATION

(IN THOUSANDS OF DOLLARS, EXCEPT PER-SHARE AMOUNTS)

	Year ended December 31,		
	2008	2007	2006
Total revenues	4,155	837	19,765
Net loss	(39,807)	(25,278)	(2,339)
Per common share -			
Basic	(0.83)	(0.75)	(0.09)
Diluted	(0.83)	(0.75)	(0.09)
Cash dividends declared per common share	—	—	—

	As at December 31,		
	2008	2007	2006
Total assets	35,976	78,635	82,718
Total long-term liabilities	11,245	15,121	17,631

Revenues increased by \$3.3 million in 2008 due to the payment of \$1.2 million from Mallinckrodt Inc. under the termination agreement for C2L octreotide and the related transfer of \$2.4 million from deferred license revenues. The net loss for 2008 was \$14.5 million higher than in 2007, as the higher revenues and a reduction of \$1.6 million in general and administrative expenses were more than offset by increased restructuring charges (\$2.1 million) and a write-down of \$19.1 million in intellectual property. The decrease in total assets in 2008 reflected primarily the cash used to finance business activities during the year and the write-down and amortization of intellectual property. The decrease in long-term liabilities in 2008 resulted primarily from the reduction of \$4.3 million in the future income tax liability. The increase in the net loss in 2007 reflects primarily the \$19.2 million of license revenues earned in 2006 and the increases in amortization expense, resulting from the Ambrilia France acquisitions in 2006, and in general and administrative expenses. The reduced level of total assets in 2007 reflected primarily the amortization of the intellectual property arising on the acquisitions of Ambrilia France. The decrease in long-term liabilities in 2007 resulted primarily from the draw-down of \$1.9 million in the future income tax liability associated with the above amortization and with the losses incurred in France during 2007.

## QUARTERLY INFORMATION

(UNAUDITED)

(THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)

	Quarter ended							
	2008				2007			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
Total revenues	75	106	3,714	260	243	183	203	208
Net income (loss)	(19,716)	(9,781)	(3,126)	(7,184)	(6,265)	(6,145)	(6,755)	(6,112)
Per common share								
Basic	(0.41)	(0.20)	(0.07)	(0.15)	(0.15)	(0.19)	(0.22)	(0.21)
Diluted	(0.41)	(0.20)	(0.07)	(0.15)	(0.15)	(0.19)	(0.22)	(0.21)
Weighted average number of common shares outstanding ('000)	48,577	48,573	47,970	47,651	42,483	32,114	30,648	29,207
Cash dividends declared	-	-	-	-	-	-	-	-

The net loss in the first quarter of 2008 was increased by a restructuring charge of \$0.6 million, while the second quarter benefited from the \$3.6 million impact of the Mallinckrodt Inc. termination agreement for C2L octreotide. The loss in the third quarter was inflated by the \$3.7 million write-down of intellectual property, while a \$15.4 million write-down of intellectual property and restructuring charges of \$1.4 million in the fourth quarter were only partially offset by a higher future income tax recovery and a lower level of operating expenses. The quarterly net losses for 2007 were relatively stable, in line with operating expenses, with the increase in the second quarter being due to the severance expense in relation to a former executive of approximately \$0.9 million.

## SIGNIFICANT PROJECTS

Each of our product candidates, which were discussed in the Overview section, will have to complete the necessary phases of clinical trials and obtain regulatory approval before they can generate significant revenues. The costs to complete these clinical trials and to obtain regulatory approval are significant and the costs associated with this process are expected to continue to be significant over the next several years. Part of these costs could be borne by various corporate partners under research collaboration and licensing agreements. The Company is presently reviewing strategic alternatives, including the divestment, strategic partnership transactions or licensing of the company's technologies and the sale or merger of the Company. The result of this review could impact the level of future expenditures to complete these clinical trials and to obtain regulatory approval.

## SEGMENTED INFORMATION

The Company operates in only one business segment, which is the sector related to the development and commercialization of diagnostic and therapeutic drugs, but in two geographic segments, as follows:

## Geographic information

	2008		2007	
	Revenues \$	Property, plant & equipment and intellectual property \$	Revenues \$	Property, plant & equipment and intellectual property \$
Canada	1,743,924	16,938,107	777,216	33,945,569
France	2,410,664	7,461,846	59,793	16,845,207
<b>Total</b>	<b>4,154,588</b>	<b>24,399,953</b>	<b>837,009</b>	<b>50,790,776</b>

## CONTRACTUAL OBLIGATIONS

A summary of the Company's contractual obligations as at December 31, 2008 is as follows:

(in thousands of dollars)	Payments due by period				Total
	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	
Operating leases	462	928	928	—	2,318
Biolevier loan facility	—	Note 1			8,927
Convertible debentures			Note 2		3,500
Obligations under licensing agreement (Note 3)	—	52	52	—	104
<b>Total</b>	<b>462</b>	<b>980</b>	<b>980</b>	<b>—</b>	<b>14,849</b>

### Notes:

- Under the terms of the Biolevier loan agreement, the loan is for a 10 year term from the date of the first disbursement, November 19, 2003, and bears interest at the Canadian prime rate plus 3%, which can be converted to a fixed rate, at the Company's option, at any time after the final loan disbursement. No capital or interest was repayable prior to November 19, 2006. In December 2006, the Company repaid an amount of \$2 million based on an agreement with Investissement Québec in connection with the Merck licensing deal. Thereafter, interest is payable monthly, with annual capital repayments equal to 25% of the Company's annual operating cash flows, excluding any milestones which have triggered loan repayments, if any. Consequently, the timing of repayments cannot be determined.
- The \$3.5 million convertible debentures issued on June 29, 2005 and maturing on June 29, 2010 are convertible into up to 777,777 common shares at a price of \$4.50 per share. The issue also included warrants to purchase 50% of the number of common shares that would be issued if the debentures were fully converted, exercisable at a price of \$5.00 per common share at any time to June 29, 2010. The fair value of the liability component at June 29, 2005 was \$1,991,500 and, with accretion to date, was recorded at \$2,872,527 at December 31, 2008. Due to the conversion option applicable to these debentures, the Company cannot determine whether any repayment will be made and, if so, the amount thereof.
- Payments totalling approximately \$1.2 million related to the NGR-Delivery platform are contingent upon the achievement of certain milestones. These are not included in the table above. Also, a minimum annual royalty of approximately \$26,000 per year for years subsequent to 2009 has been included for 4 years only.
- 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 year ended December 31, 2006, \$883,334 of government assistance as a reduction of research and development expenses. 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. Repayments will be accounted for as part of research and development expense. The timing of repayments cannot be determined.

Almost all of the Company's purchase obligations are for major contracts undertaken in the normal course of business that relate primarily to ongoing clinical trials for C2L and Goserelin. Such contracts can be terminated by the Company, subject to notice of termination of up to 3 months. In the event of termination by the Company, it will generally be liable for costs incurred up to the effective date of termination, including in certain cases expenses required to be incurred to complete activities associated with termination of the project.

There were no commitments for capital expenditures as at December 31, 2008.

On December 19, 2008, the Company entered into an agreement with a third party for assistance in monetizing certain of the Company's assets for a period of six-months. As part of the terms of the agreement, the Company has committed to pay the third-party a success fee of the greater of 2.5% of the consideration received from a related future transaction and \$350,000.

### **CONTINGENCIES**

A lawsuit has been initiated against the Company and a subsidiary by a former employee claiming wrongful dismissal. The amount claimed is € 844,000 (\$1,439,000) plus additional amounts including € 4,000,000 (\$6,818,400) related to the future monetizing of certain technologies and other expenses. The Company intends to contest this claim on the basis that the employee was dismissed for cause. The outcome of this claim is uncertain at this time. However, an amount which represents the Company's best estimate at this time has been accrued and recorded as an expense in general and administrative expenses in the consolidated financial statements in connection with this lawsuit.

### **OFF-BALANCE SHEET ARRANGEMENTS**

Except for the operating leases and royalty and consulting obligations disclosed above under "Contractual Obligations", the Company has not entered into any off-balance sheet arrangements and does not expect to enter into any, other than in the normal course of business, in the near future.

### **RELATED PARTY TRANSACTIONS**

Under the Company's Employee Share Purchase Loan Program, the former President and CEO and the former Executive Vice-President, Business Development, Licensing and IP each received in 2000 a \$100,000 non-interest bearing loan to purchase 3,816 special warrants of the Company at \$26.20 each. Both loans are collateralized by the underlying common shares of Ambri-ilia. The loans are due on April 11, 2013, but can be repaid at any time and must be repaid in full when the market price of the Company's common shares reaches \$26.50 for ten consecutive trading days, or upon termination of the borrowers' employment with the Company, subject to certain restrictions. These loans receivable are deducted from shareholders' equity. Any proceeds to be received as settlement of the loans receivable will be recorded as a capital transaction.

Under the terms of an agreement dated April 18, 2007 between the Company and its former President and CEO, who left the Company on that date, he received a lump-sum payment of \$600,000 and 33,898 common shares of the Company with a market value at that date of \$100,000. In addition, under a consulting agreement entered into on the same date, the Company paid an additional amount of \$100,000 over a 12-month period commencing on the above date. By mutual agreement between the Company and the former President and CEO, the settlement of the loan was deferred until a date to be determined by the Company, but which would be not later than December 31, 2008. The Company had a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the loan, and also to pay to the former President and CEO an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the loan balance. In accordance with the terms of the loan agreement, the Company had deposited \$50,000 in trust to cover this obligation. In the consolidated statements of operations, deficit and comprehensive loss for the year ended December 31, 2007, the general and administrative expenses include a total amount of \$877,700 for the above items. The loan was settled on December 15, 2008 following the sale of the underlying common shares for an amount of \$295 and resulted in an additional charge to general and administrative expenses in 2008 of \$15,075. The deposit was released in January 2009, following payment of the related obligation.

By mutual agreement between the Company and the former Executive Vice-President, Business Development, Licensing and IP, the settlement of the loan was deferred until a date to be determined by the Company, but which will be not later than February 28, 2010. The Company had a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the loan, and also to pay to the former Executive Vice-President, Business Development, Licensing and IP an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the loan balance. In accordance with the terms of the loan agreement, the Company has deposited \$50,000 in trust to cover this obligation. An amount of \$98,300 relating to the above is included in restructuring charges in the consolidated statements of operations, comprehensive loss and deficit for the year ended December 31, 2008.

The fair market value of the shares held as collateral at December 31, 2008 amounts to \$267.

## **PROPOSED TRANSACTIONS**

As noted under section "Significant Projects", the Company is presently reviewing strategic alternatives, including the divestment, strategic partnership transactions or licensing of the company's technologies and the sale or merger of the Company. However, at the present time, the Company has not entered into any agreements involving the acquisition or disposition by the Company of assets or businesses.

## **NEW ACCOUNTING STANDARDS ISSUED AND NOT ADOPTED**

### **Future accounting changes**

The CICA has issued the following new accounting standard, which will be effective for the Company as of January 1, 2009:

Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. The new Section, issued in February 2008, will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is in the process of assessing the impact of adopting this Section on its consolidated financial statements.

In February 2008, the CICA confirmed that Canadian public companies will be required to adopt International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), effective January 1, 2011. As a result, the Company is developing a plan to convert its consolidated financial statements to IFRS. This plan will consider the impact of IFRS on:

- accounting policies, alternatives available and implementation decisions;
- information technology and data systems;
- internal control over financial reporting;
- disclosure controls and procedures; and
- business activities.

The Company is in the process of assessing the preliminary differences between IFRS and the Company's current accounting policies, as well as the alternatives available to it upon adoption of IFRS. It has not yet quantified the effect of adopting IFRS on its financial statements, systems and business activities. In the period leading up to the conversion to IFRS, it is expected that the Accounting Standards Board of the CICA will issue new accounting standards converged with IFRS to mitigate the initial adoption of IFRS. However, the IASB will continue to issue new IFRS during the transition period and consequently this assessment will be an ongoing process, as the final impact of the new accounting standards will probably not be known until the conversion date.

## **FINANCIAL INSTRUMENTS**

The Company does not use currency or other hedging instruments.

## **OUTSTANDING SHARE DATA**

The number of common shares outstanding as of March 25, 2009 is 48,580,612, unchanged from December 31, 2008. The number of stock options outstanding at March 25, 2009 is 1,525,391, a decrease of 68,045 from December 31, 2008 due to expired options. In addition, 15,877,037 warrants are outstanding on March 25, 2009, unchanged from December 31, 2008.

Further, a total of \$4.5 million of convertible debentures were outstanding at March 25, 2009, unchanged from December 31, 2008. This includes \$3.5 million which is convertible into 777,777 common shares at any time prior to June 29, 2010, based on a conversion price of \$4.50 per common share. The balance is convertible into common shares at a price range of 125% to 150% of the market price of the common shares at the date of regulatory approval of a product for which work on the technology has been terminated.

## **RISK FACTORS**

Ambrilia'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 raise sufficient funds, 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.

### **Going Concern Uncertainty**

As at December 31, 2008, there was substantial doubt as to the Company's ability to continue as a going concern without having access to additional financial resources.

The Company has incurred significant operating losses since its inception and its anticipated level of future net annual expenditures exceeds its cash and cash equivalents as at December 31, 2008. Further, based on the Company's current projections, it is unlikely that it will be in compliance with its debt covenants beginning in the second quarter of 2009. To-date the Company has financed its cash requirements primarily by issuing common shares and debt instruments, by licensing arrangements and through investment tax credits and interest income. It is currently attempting to monetize its non-virology assets through the sale or licensing of these assets. The Company is also seeking other alternatives, including strategic partnership transactions and the sale or merger of the Company. Ambrilia's ability to continue as a going concern is subject to its ability to successfully implement these plans. There can be no assurance that these plans will materialize on a timely basis or on satisfactory terms. If the Company is unable to obtain additional financial resources, management may be required to further curtail the Company's operations.

### **Product Development**

Ambrilia cannot assure that its products will be developed successfully. Ambrilia's most advanced products are currently in the development stages and its other products are at the research stage. Its first product is designed to be a substitute for the drug C2L in its long-acting formulation. Only the results from the Phase III study now ongoing will tell whether the potential advantages of Ambrilia's proprietary formulation are confirmed and whether the product has a chance to receive formal approval from regulatory agencies.

Regarding its proprietary products, Ambrilia cannot assure that its research and development programs will result in commercially viable products. To achieve profitable operation, Ambrilia, alone or with others, must successfully develop its products. To obtain regulatory approvals for the products being developed, clinical trials must demonstrate efficacy and that the products are safe for human use. Unsatisfactory results obtained from a particular study relating to a program may cause Ambrilia or its collaborators to abandon its commitment to that program. Ambrilia cannot assure that any future animal or human test will yield favourable results.

### **Regulatory Approvals and Clinical Studies**

Ambrilia cannot assure that any of its ongoing or future clinical studies will be successful or that it will receive requisite regulatory approvals. Ambrilia's clinical trials could be delayed or suspended at any time if it is determined at any time that participants are being exposed to unacceptable health risks or that Ambrilia's products are not effective. Obtaining the requisite regulatory approvals will take several years and requires the expenditure of substantial resources. Any failure or delay in obtaining regulatory approvals could adversely affect Ambrilia's ability to commercialize its products.

If regulatory approval of any of Ambrilia's products is obtained, their manufacture, marketing and sale will be subject to ongoing and extensive governmental regulation in the United States, Europe, Canada and other countries in which Ambrilia intends to market its products, which could result in the revocation of previously granted regulatory approvals. The manufacturing facilities for Ambrilia's drug candidates are also subject to continual review and periodic inspection and approval of manufacturing modifications by regulatory authorities. Manufacturing facilities are subject to inspections by the FDA and must comply with the FDA's current good manufacturing practices, or cGMP, regulations. In complying with these regulations, manufacturers must spend funds, time and effort in the areas of production, record keeping, personnel and quality control to ensure full compliance. Regulatory authorities in other countries have similar requirements. Failure to comply with any of these post-approval requirements may, among other things, result in warning letters, product seizures, recalls, fines, injunctions, suspensions or revocations of marketing licenses, operating restrictions and criminal prosecutions. Any of these enforcement actions or any unanticipated changes in existing regulatory requirements or the adoption of new requirements could adversely affect Ambrilia's ability to market products and generate revenues.

Ambrilia has limited experience with regulatory authorities in the United States and Europe and relies on third party licensees for the filing of applications for the approval of its products. The license agreements with such third parties provides for the obligation of Ambrilia to provide licensees with an application file within a prescribed period of time. Failure to provide licensees with a complete application file within the prescribed period of time generally triggers the right to terminate the license agreement, generally, without costs. There can be no assurance that Ambrilia will be able to meet its obligations to provide a complete file within the prescribed period of time and that third party licensees will accept an extension upon the failure by Ambrilia to meet the prescribed time-frame. The exercise of such right of termination by licensees could lead to the failure or delay in obtaining regulatory approvals, which would adversely affect Ambrilia's ability to commercialize its products.

#### **Administration of Preclinical Studies and Clinical Trials**

The process of conducting preclinical studies, human clinical trial testing and obtaining required approvals for Ambrilia's products is likely to take a number of years and require the expenditure of substantial resources. The amount and timing of preclinical studies, including animal testing, to be conducted prior to the commencement of human clinical trials is at the discretion of regulators, and may involve significantly more time and money than anticipated.

In addition, human clinical trials may take longer to start and complete than anticipated. In particular, there is competition from various pharmaceutical products for access to a limited number of research clinics and patients in Canada and other countries that are qualified to participate in multi-centre human clinical trials. There can be no assurance that access to such clinics or patients will not be delayed longer than anticipated, or obtained at all.

Animal testing and human clinical trials may result in adverse animal or patient reactions or statistically insignificant results, which may require a cessation or extension of the trials, or an increase in the number of patients enrolled in a given trial or the need to undertake ancillary testing and human trials. This may result in additional delays and expenses and the termination of projects.

#### **Reliance on Third Parties to Conduct Clinical Trials**

Ambrilia has only limited experience with clinical trials. It also has limited internal resources and capacity to perform preclinical studies and clinical trials. As a result, Ambrilia hires contract research organizations, or CROs, to perform most of its pre-clinical and clinical trials for its products being developed without a partner. If the CROs that Ambrilia engages to perform its clinical trials or Ambrilia's partners do not execute their obligations as expected, Ambrilia's clinical trials may be delayed or terminated. If Ambrilia is forced to find a replacement entity to perform clinical trials, it may not be able to find a suitable entity in a timely manner or on favourable terms. Events such as these may result in delays in Ambrilia obtaining regulatory approval for its products or its ability to commercialize its products and could result in increased expenditures.

**Market Acceptance and Commercialization**

Even if Ambrilia's products are successfully developed and receive regulatory approval, they may not gain market acceptance among physicians, patients, health care payers such as private insurers and other funding parties and the medical community. The degree of market acceptance for any of Ambrilia's products will depend on a number of factors including: demonstration of the clinical efficacy and safety of its products, cost-effectiveness, pricing, potential advantage over alternative treatment methods, superiority of alternative treatment or therapeutics, marketing and distribution support for the products, and reimbursement policies of government and third-party payers. If Ambrilia fails to commercialize products or if its future products do not achieve significant market acceptance, Ambrilia will not likely generate significant revenues or become profitable.

**Dependence on Collaborative Agreements with Third Parties**

Ambrilia's dependence on collaborative agreements with third parties may not result in marketable products. If any collaborative partner fails to develop or commercialize successfully any product to which it or Ambrilia has rights, Ambrilia may be adversely affected. In addition, while Ambrilia believes that its actual and eventual collaborative partners will have sufficient economic motivation to continue their funding, it cannot assure that any of these collaborations will be continued or result in successfully commercialized products. If one or more of Ambrilia's collaborative partners fails to continue funding any particular program, the development or commercialization of any products arising out of this program could be stopped or delayed.

If conflicts arise between Ambrilia and its collaborators or its scientific advisors, the other party may act in its self-interest and not in the interest of Ambrilia's shareholders. Additionally, Ambrilia cannot assure that its collaborative partners will not pursue alternative technologies or develop alternative products either on their own or in collaboration with others, including Ambrilia's competitors, as a means for developing treatments for the diseases targeted by Ambrilia's programs. Disputes may arise with respect to the payment of milestones or the ownership of intellectual property rights to any technology or products ultimately developed with any current or future collaborative partner. Lengthy negotiations with potential new collaborative partners or disagreements between Ambrilia and its current collaborative partners may lead to delays in, or termination of the research, development or commercialization of any product Ambrilia develops, or result in time-consuming and costly litigation or arbitration.

**Manufacturing Risks**

Ambrilia has not yet introduced any products and has limited manufacturing experience. To be successful, Ambrilia's products will have to be scalable, stable and safely manufactured in clinical trial quantities and commercial quantities in compliance with current good manufacturing practices, or cGMPs, and other regulatory requirements and at acceptable costs. In order to manufacture its products in commercial quantities Ambrilia or its partners will need to develop or expand current manufacturing facilities or contract with third parties to manufacture its products. No assurance can be given that Ambrilia, or its partners or its third party contractors will be able to make the transition to commercial production or that current manufacturing facilities will be adequate or sufficient or will continue to be available to Ambrilia following the termination date of the lease on its premises. Should any of its suppliers or its partners be unable or delayed in supplying Ambrilia with sufficient supplies, no assurance can be given that Ambrilia will be able to find alternative means of supply in a short period of time and key new raw materials could become scarce or unavailable. There may be a limited number of third parties who may manufacture Ambrilia's products. Should such parties' operations suffer a material adverse effect, the manufacturing of Ambrilia's products would also be adversely affected.

**Price Controls**

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

### **Capital Requirements**

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

With regards to the concentration of credit risk, investment tax credits recoverable are due from the Québec and French governments. The cash and cash equivalents are held with two Canadian chartered banks, one French bank and Government of Canada and Ontario treasury bills. No short term investments were held as at December 31, 2008.

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

### **Share Price Volatility**

The market price of Ambrilia's Common Shares is subject to volatility. General market conditions as well as differences between Ambrilia's financial, scientific and clinical results and the expectations of investors as well as securities analysts can have a significant impact on the trading price of the Common Shares. In recent years, the stocks of many biopharmaceutical companies have experienced extreme price fluctuations, unrelated to the operating performance of the affected companies. There can be no assurance that the market price of the Common Shares will not continue to experience significant fluctuations in the future, including fluctuations that are unrelated to Ambrilia's performance. The occurrence of any of the risks and uncertainties described in this management discussion and analysis could have a material adverse effect on the price of the Common Shares.

### **Personnel**

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

### **Intellectual Property Matters**

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

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

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

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

Patent applications relating to or affecting Ambrilia's business have been filed by a number of healthcare and biopharmaceutical companies. Some of these applications have been received. A number of technologies, applications or patents may conflict with its technologies or patent applications and such conflict could reduce the scope of patent protection that it could otherwise obtain or even lead to refusal of its patent applications.

Ambrilia may not enter into licensing arrangements at a reasonable cost, or develop or obtain alternative technology in respect of patents issued to third parties that incidentally cover its products. Any liability to secure licenses or alternative technology could result in delays in the introduction of some of its products or even lead to prohibition of the development, manufacture or sale of certain products. Moreover, Ambrilia could potentially incur substantial legal costs in defending legal actions that allege patent infringement or by instituting patent infringement suits against others.

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

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

#### **Product Liability Claims**

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

#### **Fluctuations in Short-Term Revenues**

The revenues of Ambrilia in the foreseeable future will be derived primarily from products licensed to pharmaceutical and biotechnology companies. Ambrilia expects fluctuation in such short-term revenues. Accordingly, these revenues will depend in large part upon the success of these companies and Ambrilia's operating results may fluctuate substantially due to reductions and delays in their research, development and marketing expenditures. These reductions and delays may result from factors that are not within Ambrilia's control, including changes in economic conditions, changes in the regulatory environment, including governmental pricing controls affecting health care and health care providers, pricing pressures and other factors affecting research and development spending.

### **Intense Competition and Rapid Technological Changes**

The biotechnology and pharmaceutical industries are highly competitive. There are a number of pharmaceutical companies, biopharmaceutical companies, universities and research organizations actively engaged in research and development and conducting clinical trials of products or medical treatment that may be similar to, or compete with, Ambrilia's products. Increased competition and technological advancement could diminish Ambrilia's ability to become profitable or affect its profitability in the future. Some of Ambrilia's competitors have substantially greater financial and technical resources, including more extensive research and development capabilities and greater marketing, distribution, production and human resources. A number of Ambrilia's largest competitors are pursuing the development or marketing of pharmaceuticals that target the same diseases or viral infections that Ambrilia is targeting, and it is possible that the number of companies seeking to develop such products and therapies will increase. In addition, many of these competitors have significantly greater experience in undertaking pre-clinical testing and human clinical trials of new pharmaceutical products and in obtaining regulatory approvals of human therapeutic products. Accordingly, Ambrilia's existing and potential competitors may develop products sooner, or obtain regulatory approval for their products more rapidly. They may also develop superior products or technology rendering Ambrilia's products or technology non-competitive or obsolete.

### **Unproven Market**

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

### **Government Regulation**

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

### **Hazardous Material and Environmental Matters**

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

### **Foreign Currency Exchange**

Ambrilia operates and intends to generate revenue and expenses internationally, which are likely to be denominated in U.S. dollars, in euros and other foreign currencies. Ambrilia's international business is subject to risks typical of an international business including differing tax structures, myriad regulations and restrictions and general foreign exchange rate volatility. A decrease in the value of such foreign currencies relative to the Canadian dollar could result in downward price pressure for Ambrilia's products or losses from currency exchange rate fluctuations. Ambrilia cannot assure that any hedging techniques will be successful or that it will not be materially adversely affected by exchange rate fluctuations.

### **Value of Intangible Assets**

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

### **DISCLOSURE CONTROLS AND PROCEDURES**

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

The President and Chief Executive Officer and the Executive Vice-President, Finance and Chief Financial Officer, having evaluated the effectiveness of the Company's disclosure controls and procedures as at December 31, 2008, have concluded that these disclosure controls and procedures are adequate and effective and thus would have ensured that material information relating to the Company would have been known to them.

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

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

The President and Chief Executive Officer and the Executive Vice-President, Finance and Chief Financial Officer have evaluated the design and effectiveness of the Company's internal controls over financial reporting as of the end of the period covered by the annual filings and believe the design and effectiveness to be adequate to provide such reasonable assurance using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework.

Management have concluded that no changes were made to ICFRs during the year ended December 31, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

# consolidated financial statements

ambrilia biopharma Inc.  
december 31, 2008

## MANAGEMENT'S REPORT

### To the Shareholders of Ambrilia Biopharma Inc.

Management is responsible for the integrity, objectivity and reliability of the accompanying consolidated financial statements and for ensuring that all the information in the annual report is consistent with these financial statements. This responsibility includes selecting appropriate accounting policies and making estimates and other judgments consistent with Canadian generally accepted accounting principles.

Management has established and maintains control process that provide reasonable assurance that the financial records are complete and accurate, that all financial transactions are properly authorized, that assets are safeguarded and that the Company and its subsidiaries comply with all reporting requirements.

The Company's Board of Directors is responsible for overseeing management's performance of its financial reporting responsibilities. The Board delegates this responsibility to the Audit Committee, whose members are not affiliated with the Company, is appointed by the Board to review the financial statements in detail with management and to report to the directors prior to their approval of the consolidated financial statements for publication.

Ernst & Young have been appointed as the Company's auditors to report to the shareholders regarding their audit of the consolidated financial statements.



Philippe Calais  
President and Chief Executive Officer  
March 25, 2009



Monique Létourneau  
Executive Vice-President,  
Finance and Chief Financial Officer

## AUDITORS' REPORT

### To the Shareholders of Ambrilia Biopharma Inc.

We have audited the consolidated balance sheets of Ambrilia Biopharma Inc. (the "Company") as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years ended December 31, 2008 and 2007. These consolidated 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 December 31, 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.



Chartered Accountants  
Montréal, Canada  
March 26, 2009

<sup>1</sup> CA permit number 18506

## consolidated balance sheets (note 2)

AS AT DECEMBER 31

	2008 \$	2007 \$
<b>ASSETS [note 9]</b>		
<b>Current assets</b>		
Cash and cash equivalents	8,335,164	10,795,297
Short-term investments [note 4]	—	14,604,624
Accounts receivable [note 5]	238,846	411,892
Investment tax credits recoverable	2,418,663	642,352
Prepaid expenses	182,973	175,738
	<b>11,175,646</b>	<b>26,629,903</b>
Property, plant and equipment [note 6]	1,751,157	2,133,196
Intellectual property [note 7]	22,648,796	48,657,580
Other long-term assets [note 8]	400,000	1,214,712
	<b>35,975,599</b>	<b>78,635,391</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	5,207,076	3,743,044
Deferred license revenues	1,113,116	3,527,958
	<b>6,320,192</b>	<b>7,271,002</b>
Minority interest [note 3]	—	1
Biolevier loan facility [note 9]	8,322,914	8,205,038
Future income tax liability [note 10]	—	4,347,762
Convertible debentures [note 11]	2,922,527	2,568,034
	<b>17,565,633</b>	<b>22,391,837</b>
<b>Shareholders' equity</b>		
Share capital [note 12]	139,508,548	137,951,135
Warrants [note 12]	8,610,715	8,610,715
Contributed surplus [note 12]	8,918,574	8,502,544
Equity component of convertible debentures [note 11]	1,920,914	1,920,914
Deficit	(140,548,785)	(100,741,754)
	<b>18,409,966</b>	<b>56,243,554</b>
	<b>35,975,599</b>	<b>78,635,391</b>

Commitments, contingencies and guarantees [note 17]

See accompanying notes

On behalf of the Board:



Philippe Calais  
Director



Frédéric Porte  
Director

# consolidated statements of operations, comprehensive loss and deficit (note 2)

YEARS ENDED DECEMBER 31

	2008 \$	2007 \$
<b>REVENUES</b>		
License revenue [note 13]	3,592,543	35,628
Interest and other income	562,045	801,381
	<b>4,154,588</b>	<b>837,009</b>
<b>EXPENSES</b>		
Research and development	10,772,560	10,250,484
Research and development tax credits [note 14]	(1,294,121)	(845,632)
Net research and development	9,478,439	9,404,852
General and administrative	5,772,494	7,365,626
Business development	864,833	956,333
Patent expenditures	112,220	112,489
Amortization of intellectual property	8,957,447	8,413,643
Amortization of property, plant and equipment	566,443	634,131
Accretion of long-term liabilities	472,369	416,580
Interest on long-term liabilities	953,465	1,055,932
Restructuring charges [note 15]	2,275,330	208,341
Write-down of carrying value of intellectual property [note 7]	19,064,975	—
Financial charges	26,556	58,846
Foreign exchange losses	80,085	39,784
	<b>48,624,656</b>	<b>28,666,557</b>
<b>Loss before income taxes</b>	<b>(44,470,068)</b>	<b>(27,829,548)</b>
Future income tax recovery [note 10]	4,663,037	2,271,909
Foreign exchange gain on future income tax liability [note 10]	—	279,780
	<b>(4,663,037)</b>	<b>(2,551,689)</b>
<b>Net loss and comprehensive loss for the year</b>	<b>(39,807,031)</b>	<b>(25,277,859)</b>
Deficit, beginning of year	(100,741,754)	(75,463,895)
<b>Deficit, end of year</b>	<b>(140,548,785)</b>	<b>(100,741,754)</b>
Basic and diluted loss per share [note 12]	(0.83)	(0.75)
Weighted average number of common shares outstanding	48,197,420	33,637,211

See accompanying notes

## consolidated statements of cash flows

YEARS ENDED DECEMBER 31

	2008 \$	2007 \$
<b>OPERATING ACTIVITIES</b>		
Net loss for the year	(39,807,031)	(25,277,859)
Items not affecting cash		
Amortization of property, plant and equipment	566,443	634,131
Amortization of intellectual property	8,957,447	8,413,643
Write-down of carrying value of intellectual property [note 7]	19,064,975	—
Loss on disposal of property, plant and equipment	—	944
Accretion of long-term liabilities	472,369	416,581
Future income tax recovery and related exchange gain	(4,663,037)	(2,551,689)
Interest paid by issue of common shares [notes 11 and 12]	122,500	245,000
Unrealized foreign exchange loss (gain) on loan payable	—	(2,450)
Services paid by issuance of stock options [note 12]	416,030	588,993
Compensation paid by issuance of common shares [note 12]	—	100,000
	(14,870,304)	(17,432,706)
Net change in non-cash balances relating to operations [note 16]	(1,746,598)	(352,910)
<b>Cash flows related to operating activities</b>	<b>(16,616,902)</b>	<b>(17,785,616)</b>
<b>INVESTING ACTIVITIES</b>		
Acquisition of business [note 3]	(75,800)	—
Acquisition of intellectual property	(215,133)	(275,895)
Acquisition of property, plant and equipment	(159,485)	(929,532)
Proceeds from disposal of property, plant and equipment	2,268	951
Maturities of short-term investments	25,310,287	28,531,855
Purchase of short-term investments	(10,705,663)	(23,932,729)
<b>Cash flows related to investing activities</b>	<b>14,156,474</b>	<b>3,394,650</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of units	—	18,675,000
Unit issue costs	—	(1,539,074)
Issuance of common shares [note 12]	295	5,861,127
Share issue costs	—	(200,253)
Repayment of loan payable [note 3]	—	(766,391)
<b>Cash flows related to investing activities</b>	<b>295</b>	<b>22,030,409</b>
Net increase (decrease) in cash and cash equivalents	(2,460,133)	7,639,443
Cash and cash equivalents, beginning of year	10,795,297	3,155,854
<b>Cash and cash equivalents, end of year</b>	<b>8,335,164</b>	<b>10,795,297</b>
<b>Supplemental cash flow information</b>		
Cash paid during the year for:		
Interest	849,705	902,629

See accompanying notes

DECEMBER 31, 2008

**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.

**2. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY**

These consolidated financial statements have been prepared by management on a going concern basis, which assumes that the Company will continue to operate and 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 because, as at December 31, 2008, there was substantial doubt as to the Company’s ability to continue as a going concern without having access to additional financial resources.

The Company has incurred significant operating losses since its inception and has accumulated a deficit of \$140,548,785 as at December 31, 2008. Its anticipated level of future net annual expenditures exceeds its cash and cash equivalents as at December 31, 2008. Further, based on the Company’s current projections, it is unlikely that it will be in compliance with its debt covenants beginning in the second quarter of 2009. To-date the Company has financed its cash requirements primarily by issuing common shares and debt instruments, by licensing arrangements and through investment tax credits and interest income. It is currently attempting to monetize its non-virology assets through the sale or licensing of these assets to third parties. The Company is also seeking other alternatives, including strategic partnership transactions and the sale or merger of the Company. Ambrilia’s ability to continue as a going concern is subject to its ability to successfully implement these plans. There can be no assurance that these plans will materialize on a timely basis or on satisfactory terms. If the Company is unable to obtain additional financial resources, management may be required to further curtail the Company’s operations.

These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary if the Company is unable to continue as a going concern. Such adjustments could be material.

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles [“GAAP”] and have, in management’s opinion, been properly prepared within the framework of the following accounting policies.

**Changes in accounting policies**

Effective January 1, 2008, the Company adopted the following Canadian Institute of Chartered Accountants [“CICA”] Handbook Sections without restatement of prior periods.

Section 1535, Capital Disclosures. This section establishes standards for disclosing information about an entity’s capital and how it is managed to enable users of financial statements to evaluate the entity’s objectives, policies and procedures for managing capital. The impact of these changes is reflected in note 18 to the consolidated financial statements.

Section 3862, Financial Instruments – Disclosures. This section describes the required disclosures related to the significance of financial instruments on the Company’s financial position and performance and the nature and extent of risks arising for financial instruments to which the Company is exposed and how the Company manages those risks. This Section complements the principles of recognition, measurement, and presentation of financial instruments of Section 3855, Financial Instruments – Recognition and Measurement, Section 3863, Financial Instruments – Presentation and Section 3865, Hedges.

Section 3863, Financial Instruments – Presentation. This section establishes standards for presentation of financial instruments and non-financial derivatives. It replaces standards of Section 3861, Financial Instruments – Disclosure and Presentation.

## **2. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY [CONT'D]**

The impact of the adoption of Sections 3862 and 3863 is reflected in note 19 to the consolidated financial statements.

Section 1400, General Standards of Financial Statement Presentation. This section has been amended to include requirements for management to assess and disclose an entity's ability to continue as a going concern. The main features of the changes are as follows:

- Management is required to make an assessment of an entity's ability to continue as a going concern;
- In making its assessment, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date;
- Financial statements must be prepared on a going concern basis unless management intends to liquidate the entity, to cease trading or cease operations, or has no realistic alternative but to do so;
- Disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern; and
- When financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason the entity is not regarded as a going concern.

### **Basis of consolidation**

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

### **Use of 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, particularly as they relate to the recovery of long-lived assets, investment tax credits, as well as the determination of the value of stock options and warrants. 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 could be material.

### **Cash and cash equivalents**

Cash and cash equivalents consist of cash and highly liquid short-term investments with a maturity of less than three months from the date of acquisition that are readily convertible to known amounts of cash and that are subject to an insignificant risk of change in value. As at December 31, 2008, cash and cash equivalents amounted to \$347,661 and \$7,987,503 respectively [2007 – \$245,685 and \$10,549,612].

### **Short-term investments**

Short-term investments, consisting of investments with a maturity of 3 to 12 months, are initially measured at fair value and subsequently remeasured at amortized cost using the effective interest rate method. Impairments that are not considered to be temporary are recognized immediately as a charge to income.

## 2. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY [CONT'D]

### Property, plant and equipment

Property, plant and equipment are recorded at cost, net of investment tax credits. Amortization is provided on a basis and at rates assigned to amortize the cost of the assets over their estimated useful lives. The annual rates of amortization are as follows:

Laboratory equipment	10% - 30% declining balance
Manufacturing equipment	10% declining balance
Office equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold improvements	Straight-line over lease period

### Intellectual property

Intellectual property consists of patents, licenses, and scientific knowledge relating to products under development. Patent costs include legal fees to obtain patents and patent application fees.

Intellectual property is amortized on a straight-line basis over 7 to 15 years.

### Impairment of long-lived assets

Management reviews the carrying value of property, plant and equipment and intellectual property and considers whether there have been events or changes in circumstances that indicate that the carrying value may not be recoverable. The review is based on the assessment of technological changes, the Company's intended use and the estimated net undiscounted cash flows expected to be generated from the underlying asset together with its residual value (net recoverable value). If the undiscounted cash flows are less than the carrying value of the asset, then the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value generally determined on a discounted expected cash flow basis. Any impairment results in a write-down of the asset and a charge to income during the year.

### 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 from 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 collectability 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 license revenues, as are amounts that are refundable if underlying conditions are not met.

### Government assistance

Government assistance received in the form of grants, contributions and investment tax credits for qualifying research and development activities are applied as a reduction of the cost of the related property, plant and equipment or as a reduction of the applicable research and development expenses. Government assistance is recorded when reasonable assurance exists that the Company has complied with the terms and conditions of the approved grant or contribution program, or for investment tax credits, when there is reasonable assurance that they will be realized.

## **2. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY [CONT'D]**

### **Research and development**

Research costs are charged against income as incurred. Development costs are charged against income in the period of expenditure unless a development project meets the criteria specified under GAAP for deferral and amortization. The Company has not deferred any such development costs to date.

### **Income taxes**

The Company follows the liability method of accounting for income taxes according to which future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

### **Stock-based compensation**

The Company has a stock-based compensation plan, which is described in note 12. The Company applies the fair value based method to expense all stock options awarded since January 1, 2003. The value of the compensation is measured at the grant date using the Black-Scholes option pricing model. Options issued to employees, officers and directors are recognized as an expense over the vesting period with a corresponding increase to contributed surplus. Options issued to consultants are recognized as an expense at the earlier of the vesting date or over the period over which the services are performed with a corresponding increase to contributed surplus. Any consideration paid by employees, officers and directors on exercise of stock options or purchase of stock is credited to share capital.

### **Earnings per share**

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Shares issued in connection with share purchase loans are excluded from the calculation of basic earnings per share but are included for purposes of calculating diluted earnings per share when the effect is dilutive. Diluted earnings per share is calculated using the treasury stock method, giving effect to the exercise of all dilutive securities. The treasury stock method assumes that proceeds from the exercise of options are used to purchase common shares at the average market price during the period.

### **Foreign currency translation**

The consolidated financial statements are denominated in Canadian dollars. All of the Company's accounts denominated in foreign currencies, including those of its U.S. and French subsidiaries, which are considered to be integrated with the Company, are translated using the temporal method. Under this method, monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year-end exchange rates and non-monetary assets and liabilities are translated at the exchange rates prevailing when the assets were acquired or liabilities were incurred. Revenue and expenses are translated at the average rate of exchange for the period, except for amortization, which is translated using the same exchange rates as the related assets or liabilities. Gains and losses on translation of foreign currencies are included in the consolidated statement of operations, comprehensive loss and deficit.

### **Financing costs**

Costs related to the issuance of share capital or equity instruments are recorded against the related instrument.

The fair value of compensation warrants issued to brokers with respect to equity financing transactions is recorded as an increase in contributed surplus and as a charge to the related equity component, in proportion to the type of financing.

Costs associated with the issuance of debt are deferred, recorded as a reduction of the carrying value of the related debt and amortized over the term of the related debt using the effective interest method.

## 2. SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN UNCERTAINTY [CONT'D]

### Future accounting changes

The CICA has issued the following new accounting standard, which will be effective for the Company as of January 1, 2009:

Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. The new Section, issued in February 2008, will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is in the process of assessing the impact of adopting this Section on its consolidated financial statements.

## 3. BUSINESS ACQUISITION

Effective March 1, 2006, the Company acquired 87.117% of the outstanding shares of Cellpep S.A., [subsequently renamed "Ambrilia France, 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.

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 was assigned a nominal value of \$1 in this purchase price equation. Of the assets acquired, an amount of \$49,284,676 was assigned to intellectual property, which is being amortized on a straight-line basis over a 7-year period.

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. were acquired in exchange for 1,494,330 common shares of the Company in four tranches during the period ending April 1, 2008. The Company held a call option on these Cellpep S.A. securities, which it exercised 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 held 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 were assumed to be nil on the date they were issued.

On March 1 and September 4, 2007, the Company exercised its call option to acquire the second and third tranches of the 9.39% of the outstanding Ambrilia France S.A. securities covered by the Share Exchange Agreement described above, issuing 896,588 common shares of the Company in exchange, which increased the Company's ownership of Ambrilia France S.A. from 91.48% to 97.11%. The shares issued were valued at \$2,869,082, 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 \$3,416,306, \$57,132 and \$604,356 was assigned to intellectual property, property plant and equipment and future income tax liability respectively.

On March 3, 2008, the Company exercised its call option to acquire the final 30% tranche of the 9.39% of the outstanding Ambrilia France, S.A. securities covered by the Share Exchange agreement, issuing 448,318 common shares of the Company in exchange, which increased the Company's ownership of Ambrilia France, S.A. to 99.93%. The shares issued were valued at \$1,434,618, 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 \$1,708,248, \$25,823 and \$299,453 was assigned to intellectual property, property, plant and equipment and future income tax liability, respectively.

On November 7, 2008, the Company acquired the remaining 0.07% of the outstanding Ambrilia France, S.A. securities held by a minority shareholder for a cash purchase price of \$75,800. Accordingly, an amount of \$90,257, \$1,364 and \$15,822, was assigned to intellectual property, property, plant and equipment and future income tax liability respectively, with minority interest of \$1 being eliminated.

#### 4. SHORT-TERM INVESTMENTS

	2008 \$	2007 \$
No short-term investments were held at December 31, 2008. Discount notes and banker acceptances earning interest at rates ranging from 4.23% to 4.63% were held at December 31, 2007, maturing on various dates from March to June 2008.	—	14,604,624

#### 5. ACCOUNTS RECEIVABLE

	2008 \$	2007 \$
Commodity taxes recoverable	124,181	195,183
Interest receivable on short-term investments and cash equivalents	7,518	113,144
Other	107,147	103,565
	<b>238,846</b>	<b>411,892</b>

#### 6. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated amortization \$	Net carrying value \$
<b>As at December 31, 2008</b>			
Laboratory equipment	3,524,935	2,511,103	1,013,832
Manufacturing equipment	182,342	21,412	160,930
Office equipment	297,473	232,186	65,287
Computer equipment	732,976	570,542	162,434
Leasehold improvements	497,840	149,166	348,674
	<b>5,235,566</b>	<b>3,484,409</b>	<b>1,751,157</b>
<b>As at December 31, 2007</b>			
Laboratory equipment	3,427,702	2,116,001	1,311,701
Manufacturing equipment	129,427	6,470	122,957
Office equipment	298,813	214,361	84,452
Computer equipment	697,380	503,088	194,292
Leasehold improvements	497,840	78,046	419,794
	<b>5,051,162</b>	<b>2,917,966</b>	<b>2,133,196</b>

**7. INTELLECTUAL PROPERTY**

	Cost \$	Accumulated amortization \$	Net carrying value \$
<b>As at December 31, 2008</b>			
Patent costs	2,595,309	2,201,363	393,946
Purchased patents and other intellectual property	65,200,235	42,945,385	22,254,850
	<b>67,795,544</b>	<b>45,146,748</b>	<b>22,648,796</b>
<b>As at December 31, 2007</b>			
Patent costs	2,380,176	972,918	1,407,258
Purchased patents and other intellectual property	63,401,730	16,151,408	47,250,322
	<b>65,781,906</b>	<b>17,124,326</b>	<b>48,657,580</b>

The Company reviewed the carrying values of its intellectual property as at September 30, 2008 as a result of current financial market conditions and the status of its ongoing divesting activities and determined that a write-down of \$3,695,717 was required to reflect the fair value of certain of its oncology assets determined on a discounted expected cash flow basis. As at December 31, 2008, following a further review of the status of the Company's ongoing divesting activities, an additional write-down of the carrying value of the intellectual property of \$15,369,258 was deemed to be required to reflect its fair value determined on a discounted expected cash flow basis.

**8. OTHER LONG-TERM ASSETS**

	2008 \$	2007 \$
Deposit on long-term lease	400,000	400,000
Investment tax credits recoverable in more than one year	—	814,712
	<b>400,000</b>	<b>1,214,712</b>

The \$400,000 deposit on a long-term lease is interest-bearing, at the rate payable on 30 day certificates of deposit of a Canadian chartered bank, which at December 31, 2008 is 1.25% [2007 – 3.75%]. The deposit will be applied against the lease payments for the final eight months of the term of the lease, which terminates on December 31, 2013.

## 9. BIOLEVIER LOAN FACILITY

	2008 \$	2007 \$
Biolevier loan facility	8,927,466	8,927,466
Less: Deferred financing fees	(604,552)	(722,428)
	<b>8,322,914</b>	<b>8,205,038</b>

As at December 31, 2008, the facility balance with Investissement Quebec ["IQ"] is \$8,927,466. The loan facility of \$8,322,914, reported on the consolidated balance sheet at December 31, 2008, is net of financing fees of \$838,738, of which \$234,186 has been accreted to December 31, 2008. The accretion expense amounted to \$117,876 for the year ended December 31, 2008 [2007 – \$116,310]. The loan is being accreted to the full amount due on November 19, 2013 of \$8,927,466.

The significant terms and conditions of the loan agreement are as follows:

- [i] No capital or interest is repayable prior to November 19, 2006. Interest is due on a monthly basis thereafter, with annual capital repayments equal to 25% of the Company's annual operating cash flows, excluding any milestones which have triggered loan repayments, if any.
- [ii] Any equity financing and certain milestones from out licensing transactions may trigger a partial reimbursement of the balance of the loan, subject to a common agreement between the Company and IQ, considering the financial needs of the Company and the balance of the loan. In 2008 and 2007, no repayments were made to IQ.
- [iii] Interest is at the average Canadian prime rate plus 3%, representing 6.5% at December 31, 2008, [2007 – 9%] and can be converted to a fixed rate, at the Company's option.
- [iv] The loan is collateralized by a first ranking \$15,000,000 charge on all current and future assets including intellectual property of the Company and its subsidiaries. However, upon request by the Company, and subject to certain conditions, IQ will release the charge against any specific intellectual property for which the Company is in the process of entering into a licensing, marketing or operating agreement. As at October 12, 2006 and November 29, 2007, IQ released the mortgages on the PPL 100 technology and the ANsA technology respectively.
- [v] The Company is subject to a working capital ratio of 1.2, which was respected for the year ended December 31, 2008. Based on the Company's current projections, it is unlikely that it will be in compliance with the existing quarterly financial covenants beginning in the second quarter of 2009. Failure to comply with this debt covenant would result in a default on the loan and a requirement to immediately repay the loan.

In addition, on February 6, 2003 the Company provided IQ with warrants to purchase 150,375 common shares at an exercise price of \$5.60 per share, expiring 10 years from the date of their issuance. The warrants will automatically expire one year after loan repayment, if repaid according to the repayment formula described in [i] above, or two years after loan repayment in all other cases, but no later than February 6, 2013.

## 10. INCOME TAXES

The tax effects of temporary differences and net operating losses that give rise to future income tax assets and liabilities are as follows:

	2008 \$	2007 \$
<b>Future income tax liability</b>		
Carrying values of intellectual property in excess of tax basis	2,524,000	6,866,762
Others	24,000	24,000
<b>Total future income tax liability</b>	<b>2,548,000</b>	<b>6,890,762</b>
<b>Future income tax assets</b>		
Net operating losses carried forward – U.S.A.	541,000	438,000
Net operating losses carried forward – Canada	11,652,000	11,052,000
Net operating losses carried forward – France	3,368,000	1,404,000
Research and development expenditures	16,924,000	14,529,000
Carrying values of property, plant and equipment below tax basis	278,000	170,000
Carrying values of intellectual property below tax basis	4,024,000	658,000
Financing fees and share issue costs	406,000	553,000
Total future income tax assets	37,193,000	28,804,000
Valuation allowance	34,645,000	26,261,000
Net future income tax assets	2,548,000	2,543,000
<b>Net future income tax liability</b>	<b>—</b>	<b>4,347,762</b>

The income tax reported differs from the amount of the tax computed by applying statutory income tax rates to the loss before taxes. The reasons for the differences and the related tax effects are as follows:

	2008 %	2007 %
Combined statutory federal and provincial rates	30.90	32.02
Increase (decrease) in taxes recoverable resulting from:		
Non-deductible expenses and other differences	(9.81)	(4.49)
Unrecognized tax benefits of operating losses and research and development expenditures	(8.81)	(2.95)
Tax credits not taxable in Québec	0.14	0.20
Effect of foreign tax rates	0.99	0.54
Effect of losses expiring and foreign exchange	(1.32)	—
Income tax rate adjustment	(1.60)	(17.16)
	<b>10.49</b>	<b>8.16</b>

## 10. INCOME TAXES [CONT'D]

The Company has accumulated loss carry-forwards for Federal and Québec purposes, which are available to reduce future taxable income. A tax benefit of \$24,000, representing \$88,000 of federal and Quebec tax losses has been recognized in these consolidated financial statements as a net future income tax asset. These loss carry-forwards expire as follows:

	Federal \$	Québec \$
2009	5,304,000	5,153,000
2010	6,755,000	6,630,000
2014	9,320,000	9,289,000
2015	7,051,000	7,042,000
2026	457,000	456,000
2027	6,094,000	6,091,000
2028	8,454,000	8,454,000
	<b>43,435,000</b>	<b>43,115,000</b>

The Company has approximately \$57,048,000 of research and development expenditures available for Federal tax purposes and \$70,306,000 for Québec tax purposes that are available to reduce taxable income in future years and have an unlimited carryforward period, the tax benefit of which has not been reflected in these consolidated financial statements.

The Company has accumulated net operating loss carry-forwards in the U.S. of \$1,306,000. The tax benefit of these losses has not been recognized in these consolidated financial statements. These losses have carry-forward periods of from 15 to 20 years and expire from 2011 to 2027.

The Company has accumulated net operating loss carry-forwards in France of \$9,782,000 that are available to reduce future taxable income. A tax benefit of \$3,368,000, representing \$9,782,000 of France tax losses has been recognized in these consolidated financial statements as a net future income tax asset. These losses have an unlimited carry-forward period.

## 11. CONVERTIBLE DEBENTURES

	2008 \$	2007 \$
[i] Convertible debentures, maturing June 29, 2010		
Face value	3,500,000	3,500,000
Less: allocated equity component and warrants	(1,508,500)	(1,508,500)
Liability component	1,991,500	1,991,500
Less: Deferred financing costs	(353,077)	(353,077)
	1,638,423	1,638,423
Add: Accumulated accretion	1,234,104	879,611
	<b>2,872,527</b>	<b>2,518,034</b>
[ii] Convertible debentures, maturing December 31, 2049		
Face value	1,055,000	1,055,000
Less: allocated equity component	(1,005,000)	(1,005,000)
	50,000	50,000
	<b>2,922,527</b>	<b>2,568,034</b>

## 11. CONVERTIBLE DEBENTURES [CONT'D]

### [i] Convertible debentures, maturing June 29, 2010

On June 29, 2005, concurrent to the acquisition of Bioxalis Medica Inc., the Company completed a \$3,500,000 financing by way of a private placement of convertible debentures maturing on June 29, 2010. The \$1,000 nominal value unsecured debentures bear interest at an annual rate of 7% (effective rate of 13.2%), payable semi-annually in cash or common shares at Ambrilia's option, but subject to a maximum number of common shares issuable for this purpose approved by the Toronto Stock Exchange at the time of issuance of the debentures. Following the Company's election to issue common shares in payment of interest on June 29, 2008, it is no longer able to elect to make payment in shares. The debentures are convertible, in whole or in part, into up to 777,777 common shares of Ambrilia at a price of \$4.50 per share. In the event that the Company elects to pay interest in common shares, the number of shares issued is based on 95% of the weighted-average price of the Company's common shares for the 5 days prior to the payment date. Purchasers of the convertible debentures also received warrants to purchase 50% of the number of common shares that would be issued if the debentures were fully converted [388,887 common shares]. Each full warrant is exercisable at a price of \$5.00 per share at any time to June 29, 2010. In the event of a change in control of in excess of 60% of the voting securities of the Company, as defined in the agreement, the holders of the debentures may elect, within 30 days of receipt of notice of change in control, to redeem in cash, including accrued interest, at a redemption price equal to 110% of the principal amount of the debentures.

In addition to cash commissions and other issue costs totalling \$337,602, the Company granted 9,999 compensation warrants to the underwriter to purchase 6,666 common shares at \$4.50 per share and 3,333 common shares at \$5.00 per share, all of which were exercisable at any time to June 29, 2007. These compensation warrants had an estimated fair value at \$15,475, determined using the Black-Scholes option pricing model with a volatility of 84%, a risk-free interest rate of 2.9%, a dividend yield of nil and an expected life of two years. On June 29, 2007, these compensation warrants expired without value.

The \$3,500,000 face value of the convertible debentures have been allocated to the debt and equity components, with \$1,991,500 included in liabilities, \$1,018,500 recorded as the equity component of the convertible debenture and \$490,000 as the value of the warrants. The equity component and the value of the warrants have been determined using the Black-Scholes option pricing model with a volatility of 70%, a risk-free interest rate of 3.3%, a dividend yield of nil and an expected life of five years. The liability component, net of financing costs, is being accreted over time by a charge to income for imputed interest and at maturity will be equal to the face value of the debentures. The accretion expense amounted to \$354,493 for the year ended December 31, 2008 [\$300,271 in 2007].

### [ii] Convertible debenture, maturing December 31, 2049

On February 1, 2000, the Company entered into a Canadian licensing agreement with a biopharmaceutical company [the "Holder"] whereby the Holder would advance funds to the Company upon the achievement of specific scientific and regulatory milestones related to Fibrostat®. A total of \$1,055,000 was advanced in the form of a non-interest bearing debenture, convertible into common shares and maturing on December 31, 2049. The Holder of the debenture has a right to convert the debenture into common shares at the date regulatory approval is obtained for Fibrostat®, a technology on which work has been discontinued. As at December 31, 2008, of the amount received by the Company, \$50,000 is included in liabilities and \$1,005,000 is recorded as the equity component of the convertible debenture. The liability component is being accreted over time by a charge to income for imputed interest and at maturity will be equal to the face value of the debenture.

## 12. SHAREHOLDERS' EQUITY

### Authorized

#### *Common Shares*

An unlimited number of common shares.

#### *First Preferred Shares*

An unlimited number of non-voting First Preferred Shares without par value, shall be issuable in series and the Board of Directors of the Company shall have the right to fix the number of, and to determine the rights and conditions attached, to these shares.

#### *Second Preferred Shares*

An unlimited number of non-voting Second Preferred Shares without par value, shall in all respects be subject to and subordinate to the rights and conditions attaching to the First Preferred Shares.

### Issued and outstanding

#### *Share capital*

	Number of common shares	Share capital \$
<b>Balance as at December 31, 2006</b>	<b>29,024,439</b>	<b>114,401,167</b>
<b>Acquisition of Ambrilia France [note 3]</b>		
March 1, 2007	448,294	1,434,541
September 4, 2007	448,294	1,434,541
<b>Public offering</b>		
October 30 and November 8, 2007	14,940,000	15,985,800
Unit issuance costs – cash	—	(1,317,448)
<b>Private placement</b>		
March 18 and 22, 2007	2,417,353	5,849,995
Share issuance costs – cash	—	(200,253)
<b>Other</b>		
Stock options exercised	4,123	11,132
Amount transferred from “Contributed surplus” relating to stock options exercised	—	6,660
Issued as compensation	33,898	100,000
Issued in payment of interest on convertible debentures	198,915	245,000
<b>Balance as at December 31, 2007</b>	<b>47,515,316</b>	<b>137,951,135</b>
<b>Acquisition of Ambrilia France [note 3]</b>		
March 3, 2008	448,318	1,434,618
<b>Other</b>		
Issued in payment of interest on convertible debentures	616,978	122,500
Sale of shares held as security for employee loan	—	295
<b>Balance as at December 31, 2008</b>	<b>48,580,612</b>	<b>139,508,548</b>

## 12. SHAREHOLDERS' EQUITY [CONT'D]

### Public offering

On October 22, 2007 the Company filed a short-form prospectus for the issuance of 12,450,000 units [the "Units"] at a price of \$1.25 per Unit, for total proceeds of \$15,562,500, before issue expenses. Each Unit consists of one common share of the Company and one-half of one warrant. Each whole warrant will enable the holder to purchase one additional common share at an exercise price of \$1.35 per share to October 29, 2010. The Company has granted to the underwriters an over-allotment option [the "Over-allotment option"], which entitles the underwriters to acquire up to a number of additional Units equal to 15% of the Units sold under this offering at the issue price of \$1.25 per Unit. The underwriters were also granted an option [the "Underwriters' option"] to acquire up to 622,500 additional Units at a price of \$1.25 per Unit.

In addition, the warrant holders have a net exercise right that enables them to receive, without payment, the number of common shares equal to the quotient of the "aggregate fair market value" (value weighted average price for the five days preceding the exercise date) of the common shares less the aggregate exercise price of the warrants divided by the fair market value of one common share on the date of the exercise.

Closing of the transaction took place on October 30, 2007, with the Underwriters' option being fully exercised. On November 8, 2007, the underwriters exercised in full the Over-allotment option. Consequently, a total of 14,940,000 common shares and 7,470,000 warrants were issued in exchange for gross proceeds of \$18,675,000. The fair value of the warrants is estimated at \$2,689,200, determined using the Black-Scholes option pricing model with a volatility of 60%, a risk-free interest rate of 4.3%, a dividend yield of nil and an expected life of three years. Cash expenses of the financing amounted to \$1,539,074, of which \$1,317,448 has been allocated to share capital and \$221,626 to warrants. Net proceeds of \$17,135,926 were obtained, with \$14,668,352 allocated to share capital and \$2,467,574 to warrants.

### Private placement

On May 18 and 22, 2007, Ambrilia issued a total of 2,417,353 common shares by way of a private placement at a price of \$2.42 per share, for an aggregate consideration of \$5,849,995, before cash issue expenses of \$200,253.

### Other

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

The Company elected to issue during 2008 a total of 616,978 [2007 – 198,915] common shares as payment for the cumulative interest for the 6 months ended June 29, 2008 [2007 – 12 months ended December 29, 2007] on the \$3,500,000 convertible debentures maturing June 29, 2010 [note 11].

### Employee share purchase loan program

Under the Company's Employee Share Purchase Loan Program, the former President and CEO and the former Executive Vice-President, Business Development, Licensing and IP each received in 2000 a \$100,000 non-interest bearing loan [the "Loan"] to purchase 3,816 special warrants of the Company at \$26.20 each. Both loans are collateralized by the underlying common shares of Ambrilia. The loans are due on April 11, 2013, but can be repaid at any time and must be repaid in full when the market price of the Company's common shares reaches \$26.50 for ten consecutive trading days, or upon termination of the borrowers employment with the Company, subject to certain restrictions. These loans receivable are deducted from shareholders' equity. Any proceeds received as settlement of the loans receivable are recorded as a capital transaction.

## 12. SHAREHOLDERS' EQUITY [CONT'D]

Under the terms of an agreement dated April 18, 2007 between the Company and its former President and CEO, who left the Company on that date, he received a lump-sum payment of \$600,000 and 33,898 common shares of the Company with a market value at that date of \$100,000. In addition, under a consulting agreement entered into on the same date, the Company paid an additional amount of \$100,000 over a 12-month period commencing on the above date. By mutual agreement between the Company and the former President and CEO, the settlement of the Loan was deferred until a date to be determined by the Company, but which would be not later than December 31, 2008. The Company had a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the Loan, and also to pay to the former President and CEO an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the Loan balance. In accordance with the terms of the Loan agreement, the Company had deposited \$50,000 in trust to cover this obligation. In the consolidated statements of operations, deficit and comprehensive loss for the year ended December 31, 2007, the general and administrative expenses include a total amount of \$877,700 for the above items. The loan was settled on December 15, 2008 following the sale of the underlying common shares for an amount of \$295 and resulted in an additional charge to general and administrative expenses in 2008 of \$15,075. The deposit was released in January 2009, following payment of the related obligation.

By mutual agreement between the Company and the former Executive Vice-President, Business Development, Licensing and IP, the settlement of the Loan was deferred until a date to be determined by the Company, but which will be not later than February 28, 2010. The Company had a pre-existing obligation, upon the sale of these 3,816 common shares of the Company, to forgive any shortfall arising following the application of the proceeds of sale in repayment of the Loan, and also to pay to the former Executive Vice-President, Business Development, Licensing and IP an amount sufficient to offset any negative income tax consequences stemming from the forgiveness of the Loan balance. In accordance with the terms of the Loan agreement, the Company has deposited \$50,000 in trust to cover this obligation. An amount of \$98,300 relating to the above is included in restructuring charges in the consolidated statements of operations, deficit and comprehensive loss for the year ended December 31, 2008.

The fair market value of the shares held as collateral at December 31, 2008 amounts to \$267 [2007 – \$9,200].

### **Stock option plan**

The Company has granted stock options to employees, directors, officers and consultants of the Company under a stock option plan, which expired on June 30, 2008 and which will be renewed, subject to the approval of the Company's shareholders, at the next Annual General Meeting. Accordingly, as of December 31, 2008, no common shares were available for issuance under the stock option plan [2007 - 4,751,532]. Options granted to employees and officers vest over two to three years and expire five to seven years [three years for options granted from August 2001 to November 2004] from the grant date. Generally, options granted to directors vest immediately. In addition to the options shown below, a grant of 424,219 options to employees on August 11, 2008 is conditional upon obtaining shareholders' approval.

## 12. SHAREHOLDERS' EQUITY [CONT'D]

Changes in the number of options are as follows:

	2008		2007	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Options outstanding, beginning of year	1,023,267	3.28	619,381	5.26
Granted	699,199	0.58	572,659	2.53
Forfeited	(129,030)	2.47	(30,750)	3.54
Expired	—	—	(133,900)	9.18
Exercised	—	—	(4,123)	2.70
Options outstanding, end of year	1,593,436	2.13	1,023,267	3.28
Exercisable, end of year	1,235,640	2.37	522,757	4.26

Additional information concerning stock options outstanding as at December 31, 2008 is as follows:

Price range \$	Options outstanding			Options exercisable	
	Number of outstanding options	Weighted average months remaining	Weighted average exercise price \$	Number of exercisable options	Weighted average exercise price \$
0.35 to 0.52	372,949	76	0.35	372,949	0.35
0.84 to 1.26	326,250	73	0.84	126,250	0.84
2.13 to 3.05	567,979	54	2.30	412,796	2.35
3.38 to 4.10	171,930	33	3.78	169,317	3.77
6.70 to 9.90	154,328	11	7.03	154,328	7.03
0.35 to 9.90	1,593,436	56	2.13	1,235,640	2.37

An amount of \$416,030 [2007 - \$588,993] was recorded as an expense and was credited to contributed surplus in 2008. The fair value of stock options at the grant date was estimated using the Black-Scholes option pricing model with the following assumptions:

	2008	2007
Expected dividend	Nil	Nil
Expected volatility	69%	67%
Risk-free interest rate	3.5%	4.3%
Expected option life	7 years	5-7 years
<b>Weighted average stock option fair value</b>	<b>\$0.39</b>	<b>\$1.71</b>

## 12. SHAREHOLDERS' EQUITY [CONT'D]

### Warrants

	Number of common shares reserved for issuance	\$
<b>Balance as at December 31, 2006</b>	<b>10,759,810</b>	<b>6,143,141</b>
<b>Acquisition of Ambrilia France [note 3]</b>		
Exercise of acquisition warrants	(896,588)	—
<b>Public offering</b>		
October 30 and November 8, 2007	7,470,000	2,689,200
Issuance costs	—	(221,626)
<b>Other</b>		
Expired warrants	(267,581)	—
<b>Balance as at December 31, 2007</b>	<b>17,065,641</b>	<b>8,610,715</b>
<b>Acquisition of Ambrilia France [note 3]</b>		
Exercise of acquisition warrants	(448,318)	—
<b>Other</b>		
Expired warrants	(740,286)	—
<b>Balance as at December 31, 2008</b>	<b>15,877,037</b>	<b>8,610,715</b>

On March 1, 2008, the 370,143 broker compensation warrants related to the March 1, 2006 private placement expired without value, together with an equal number of warrants attached thereto.

On September 30, 2007, a total of 157,584 warrants issued to the former shareholders of Oncologic expired without value. On June 29, 2007, a total of 9,999 compensation warrants expired without value. On March 15, 2007, the 99,998 warrants related to the Bioxalis acquisition expired without value. These warrants previously had no value attributed to them, since it was not determinable at the time of granting.

The expiry dates and common share equivalent for the outstanding warrants are as follows:

	Expiry date	Common share equivalent	Exercise price \$
Convertible debentures issued June 29, 2005 [note 11]	June 29, 2010	388,887	5.00
Warrants from March 1, 2006 private placement	March 1, 2011	7,867,775	3.50
Investissement Quebec warrants [note 9]	February 6, 2013	150,375	5.60
Warrants from October 30 and November 8, 2007 public offering	October 29, 2010	7,470,000	1.35
		<b>15,877,037</b>	

## 12. SHAREHOLDERS' EQUITY [CONT'D]

### Contributed surplus

	\$
<b>Balance as at December 31, 2006</b>	<b>7,920,211</b>
Options issued to consultants [i]	3,634
Options granted to employees and directors	585,359
Options exercised in 2007 [see "Share capital"]	(6,660)
<b>Balance as at December 31, 2007</b>	<b>8,502,544</b>
Options granted to employees and directors	416,030
<b>Balance as at December 31, 2008</b>	<b>8,918,574</b>

[i] During 2007, in consideration for services rendered, options were issued to consultants to purchase 2,500 common shares at a price of \$2.16 per share expiring in 2014. These options are included in the table under the stock option plan above. Management has estimated the fair value of these options, using the Black-Scholes option pricing model, with a volatility factor of 66%, a risk free interest rate of 4.3%, a dividend yield of nil and an estimated life of 7 years, to be \$3,634. Since the options were fully vested at the grant date, this amount has been recorded as an expense in 2007.

### Diluted earnings per share

No options or warrants outstanding at December 31, 2008 and 2007 were included in the calculation of diluted earnings per share, as all such securities would be anti-dilutive. Common shares granted subject to share purchase loans were also excluded since they would also have been anti-dilutive.

## 13. TERMINATION PAYMENT

On May, 13, 2008, the Company, through its majority-owned subsidiary Cellpep Pharma Inc., entered into an agreement with Mallinckrodt Inc., a Covidien Company, whereby the Product Development and Licensing Agreement ("the Agreement") entered into June 1, 2004 by and between Mallinckrodt Inc. and Ambrilia Biopharma France S.A. for the development and marketing of an injectable C2L acetate dosage pharmaceutical product was terminated, effective immediately, with Mallinckrodt Inc. relinquishing all license and marketing rights to the product and agreeing to pay Cellpep Pharma Inc. an amount of \$1,185,815 (US\$1,200,000) within 15 days of termination of the Agreement. Termination of the Agreement resulted from a change in business strategy by Mallinckrodt.

Such amount, together with the reversal of approximately \$2.4 million of deferred license revenues related to the Agreement, was accounted for as License revenue in the consolidated statement of operations, comprehensive loss and deficit.

## 14. GOVERNMENT ASSISTANCE, INCLUDING INVESTMENT TAX CREDITS

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 year ended December 31, 2006, \$883,334 of government assistance as a reduction of research and development expenses.

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. Repayments, if any, will be accounted for as part of research and development expense.

In addition, the Company incurred research and development expenditures that are eligible for investment tax credits. The investment tax credits recorded, amounting to \$1,294,121 for the year ended December 31, 2008 [2007 - \$845,632], are based on management's estimates of amounts that are expected to be recovered and that are subject to audit by taxation authorities.

#### 14. GOVERNMENT ASSISTANCE, INCLUDING INVESTMENT TAX CREDITS [CONT'D]

Investment tax credits earned in connection with certain research and development expenditures incurred in Québec are fully refundable. The non-refundable Federal investment tax credits earned can be applied against taxes payable in future years, and the Company has accumulated Federal non-refundable investment tax credits of approximately \$9,907,000. The benefit of these tax credits has not been reflected in these consolidated financial statements. These investment tax credits expire as follows:

	\$
2009	305,000
2010	297,000
2011	998,000
2012	624,000
2013	1,155,000
2014	1,665,000
2015	1,247,000
2026	1,229,000
2027	1,266,000
2028	1,121,000
	<b>9,907,000</b>

#### 15. RESTRUCTURING CHARGES

	2008 \$	2007 \$
Severance payments	<b>2,275,330</b>	208,341

##### 2008

Under the terms of an agreement dated February 29, 2008 between the Company and its former Executive Vice-President, Business Development, Licensing and IP, the former employee will receive severance of \$510,601 in cash, benefits and immediate vesting of outstanding options. In addition, the Company has a pre-existing obligation upon settlement of the \$100,000 Loan under the Company's Employee Share Purchase Loan Program [note 12] and a related amount of \$98,300 was expensed during the year for a total of \$608,901.

On September 29, 2008, the Company announced that it had elected to prioritize its divestment strategy of monetizing its clinical assets C2L and goserelin, along with cost-cutting actions which resulted in a hold on its antiviral research and development activities and a 33% reduction in headcount. Accordingly, a restructuring plan was implemented which resulted in the termination of fourteen employees in the basic research and preclinical team and administrative support functions. The costs associated with this restructuring amounted to \$302,374, which was expensed in the current period. Management does not anticipate further costs and deems that this restructuring process is complete.

On December 18, 2008, the Company announced that it had taken additional cost-cutting actions resulting in further reduction in cash consumption and a decrease in headcount in order to further preserve its cash into 2009. Although continuing to pursue its divestment strategy of monetizing its clinical assets C2L and goserelin, it will also explore all other strategic options available to it to protect and enhance shareholder value. The additional restructuring costs associated with these actions were expensed in the current period and amounted to \$112,132. Management does not anticipate further costs and deems that this restructuring process is complete.

## 15. RESTRUCTURING CHARGES [CONT'D]

On November 19, 2008, the Company announced that it intended to initiate a plan aimed at significantly reducing its activities in France. On February 4, 2009, the Company completed the process and announced that it had implemented the major reduction of its activities in France, resulting in the layoff of all the permanent employees based in France. Accordingly, the related restructuring costs pertaining to the related legal and contractual obligations of \$1,251,923 (€744,339) were expensed in the current period. An additional expense of approximately \$398,000 (€233,339) will be recorded in the first quarter of 2009. Management does not anticipate further costs and deems that this restructuring process is complete.

The provision for restructuring charges included in accounts payable and accrued liabilities as at December 31, 2008 amounted to \$1,467,786.

### 2007

During the third quarter of 2007, the Company decided to progressively refocus its research and development activities solely on anti-virals. Accordingly, a restructuring plan was implemented and resulted in the termination of four employees, mainly in the oncology research and administrative support functions. The costs associated with this restructuring amounted to \$208,341 and were expensed in 2007. Management did not anticipate further costs and deemed this restructuring process relating to the refocusing of the Company's research and development activities solely on anti-virals complete.

## 16. NET CHANGE IN NON CASH BALANCES RELATING TO OPERATIONS

The net change in non cash working capital balances relating to operations represents the following:

	2008 \$	2007 \$
Decrease (increase) in:		
Accounts receivable	173,046	435,796
Investment tax credits recoverable	(1,776,311)	1,516,578
Prepaid expenses	(7,235)	(59,584)
Other long-term assets	814,712	(119,582)
	<b>(795,788)</b>	1,773,208
Increase (decrease) in:		
Accounts payable and accrued liabilities	1,464,032	(2,276,100)
Deferred license revenues	(2,414,842)	149,982
	<b>(950,810)</b>	(2,126,118)
	<b>(1,746,598)</b>	(352,910)

## 17. COMMITMENTS, CONTINGENCIES AND GUARANTEES

### [a] Operating leases

The Company is committed under operating leases for premises and equipment in the following amounts:

	\$
2009	462,000
2010	464,000
2011	464,000
2012	464,000
2013	464,000
	<b>2,318,000</b>

### [b] Commitments

The Company is also committed under a licensing agreement to a minimum annual royalty of approximately \$26,000 for years subsequent to 2009. In addition, should Ambrilia enter into a sub-licensing agreement with a third party, it would make payments conditional on achieving certain milestones, to a maximum of approximately \$1.2 million.

On December 19, 2008, the Company entered into an agreement with a third party for assistance in monetizing certain of the Company's assets for a period of six-months. As part of the terms of the agreement, the Company has committed to pay the third-party a success fee of the greater of 2.5% of the consideration received from a related future transaction and \$350,000.

### [c] Contingencies

A lawsuit has been initiated against the Company and a subsidiary by a former employee claiming wrongful dismissal. The amount claimed is €844,000 (\$1,439,000) plus additional amounts including €4,000,000 (\$6,818,400) related to the future monetizing of certain technologies and other expenses. The Company intends to contest this claim on the basis that the employee was dismissed for cause. The outcome of this claim is uncertain at this time. However, an amount which represents the Company's best estimate at this time has been accrued and recorded as an expense in general and administrative expenses in these consolidated financial statements in connection with this lawsuit.

### [d] Guarantees

The Company periodically enters into research agreements or strategic alliances 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 third party intellectual property claims or damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is not limited.

These indemnification provisions generally survive termination of the underlying agreement. The nature of the intellectual property 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 these consolidated financial statements with respect to these indemnification obligations.

## 18. MANAGEMENT OF CAPITAL

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and to fund its operations.

In the management of capital, the Company includes shareholders' equity, Biolevier loan facility and convertible debentures in the definition of capital as follow:

	<b>December 31, 2008</b>	December 31, 2007
	<b>\$</b>	<b>\$</b>
Biolevier loan facility	<b>8,322,914</b>	8,205,038
Convertible debentures	<b>2,922,527</b>	2,568,034
Shareholders' equity	<b>18,409,966</b>	56,243,554
	<b>29,655,407</b>	67,016,626

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets.

The Company responded to the ongoing turmoil in financial markets and the resulting difficulties in obtaining financing, in managing its capital during the period. On September 29, 2008, the Company elected to favour its divestment strategy of monetizing its oncology assets through third party agreements to strengthen its financial position and increase its cash on hand to delay any future financing. In parallel, the Company announced that it was placing a hold on its antiviral research and development activities, resulting in a 33% reduction in headcount and a significant reduction in cash consumption. Also, the Company has taken steps to ensure the safety of its existing cash equivalents by moving most of these investments into treasury bills.

## 19. FINANCIAL INSTRUMENTS

### Fair values

Fair value is subjective in nature, requiring valuation techniques and assumptions. Fair value amounts disclosed in these consolidated financial statements represent the Company's estimate of the price at which a financial instrument could be exchanged in a market in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. They are point-in-time estimates that may change in subsequent reporting periods due to market conditions or other factors.

### Short-term financial assets and liabilities

The carrying amounts of accounts receivable and accounts payable and accrued liabilities are a reasonable estimate of their fair values because of the short maturity of these instruments. The fair values of cash equivalents and short-term investments are derived from their quoted values. The effective rate of return on cash equivalents and short-term investments at December 31, 2008 is approximately 3.19% [2007 – 4.29%].

### Long-term financial liabilities

The fair value of the Biolevier loan facility is estimated using a discount rate of 11.5% and that of the debt component of the convertible debentures using a discount rate of 12% [2007 - 11%]. In both cases the discount rate is 5% higher than the contractual interest rate on the debt.

## 19. FINANCIAL INSTRUMENTS [CONT'D]

### Classification

The classification of financial instruments and their respective carrying values and fair values are as follows:

	December 31, 2008		December 31, 2007	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
<b>FINANCIAL ASSETS</b>				
<b>Held for trading:</b>				
Cash	347,661	347,661	245,685	245,685
<b>Held to maturity:</b>				
Cash equivalents	7,987,503	7,996,708	10,549,612	10,572,847
Short-term investments	—	—	14,604,624	14,698,241
	<b>7,987,503</b>	<b>7,996,708</b>	25,154,236	25,271,088
<b>Loans and receivables:</b>				
Accounts receivable (1)	114,665	114,665	216,709	216,709
<b>Total financial assets</b>	<b>8,449,829</b>	<b>8,459,034</b>	25,616,630	25,733,482
<b>FINANCIAL LIABILITIES</b>				
<b>Other financial liabilities:</b>				
Accounts payable and accrued liabilities (2)	4,210,831	4,210,831	3,053,304	3,053,304
Biolevier loan facility	8,322,914	7,006,511	8,205,038	8,205,038
Convertible debentures	2,922,527	3,271,870	2,568,034	2,718,890
<b>Total financial liabilities</b>	<b>15,456,272</b>	<b>14,489,212</b>	13,826,376	13,977,232

(1) Excludes commodity taxes recoverable as these amounts are not a contractual right to receive cash.

(2) Excludes a provision for investment tax credits recoverable in addition to a leasehold inducement accrual as these amounts are not contractual obligations to pay cash.

### Credit risk

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

This risk may affect cash, cash equivalents and short-term investments and it is mitigated by the Company's compliance with its investment policy objectives. These objectives are focussed on return, safety of capital and liquidity. At December 31, 2008, the cash and cash equivalents are held in Government of Canada and Province of Ontario treasury bills. No short-term investments are held. Cash equivalents are all held in securities with ratings of R-1 (mid) or higher by DBRS ("Dominion Bond Rating Service").

The Company's maximum credit risk exposure corresponds to the carrying values of its cash, cash equivalents, short-term investments and accounts receivable.

### Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in the market interest rates. The Company's objective in managing this risk is to minimize the net impact of potential increases or decreases in fair value and future cash flows.

## 19. FINANCIAL INSTRUMENTS [CONT'D]

This potential risk affects the Biolevier loan facility contracted at a variable interest rate, which risk is offset by the cash equivalents which, due to their short-term maturities, have interest rates that reflect approximate market interest rates.

Based on the carrying value of the cash and of the Biolevier loan facility as at December 31, 2008, both of which are affected by this risk, an assumed 2.0% increase or decrease in interest rates as at December 31, 2008 would have increased or decreased the net loss and comprehensive loss by approximately \$176,000.

### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's objective is to provide for expected cash requirements and accommodate for changes in liquidity needs.

The Company manages this risk by managing its capital structure, through continuous monitoring of its actual and projected cash flows and by abiding by its investment policy.

The following are the contractual maturities of financial liabilities at December 31, 2008:

	Carrying values	Maturities		
		Less than 1 year	1 to 5 years	Greater than 5 years
Accounts payable and accrued liabilities	4,210,831	4,210,831	—	—
Biolevier loan facility <sup>(1)</sup>	8,322,914	—	8,927,466	—
Convertible debentures <sup>(2)</sup>	2,922,527	—	3,500,000	1,055,000
	<b>15,456,272</b>	<b>4,210,831</b>	<b>12,427,466</b>	<b>1,055,000</b>

(1) Timing of repayments cannot be determined, but loan is due on November 13, 2013 at the latest.

(2) The maturities of the \$3,500,000 and \$1,055,000 convertible debentures are on June 29, 2010 and December 31, 2049, respectively.

### Currency risk

Currency risk is the risk that the future cash flows of foreign currency financial instruments will fluctuate due to changes in the foreign exchange rate of the Canadian dollar against the foreign currencies. At December 31, 2008, the Company has not entered into any currency hedging contracts to manage this risk.

The Company's main objective in managing its foreign exchange risk is to minimize the risk by acquiring foreign currency only when required to discharge its obligations.

The Company is exposed to currency risk denominated either in U.S. dollars or in Euro, as shown in the following table:

Exposures	U.S. Dollars		Euro	
	Dec. 31, 2008	Dec. 31, 2007	Dec. 31, 2008	Dec. 31, 2007
Cash	3,410	36,662	35,463	60,571
Accounts receivable	—	—	70,313	38,736
Accounts payable and accrued liabilities	299,033	222,529	1,321,551	707,346

## 19. FINANCIAL INSTRUMENTS [CONT'D]

Based on the above exposures at December 31, 2008, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar and Euro would result in an increase or decrease in the Company's net loss and comprehensive loss of approximately \$36,000 applicable to the U.S. dollar exposure and approximately \$207,000 applicable to the Euro exposure.

## 20. SEGMENTED INFORMATION

The Company operates in only one segment, which is the sector related to the development and commercialization of diagnostic and therapeutic drugs. All revenues earned and substantially all operations are carried out in Canada and France and all assets are located in Canada and France.

### Geographic information

	2008		2007	
	Revenues \$	Property, plant and equipment and intellectual property \$	Revenues \$	Property, plant and equipment and intellectual property \$
Canada	1,743,924	16,938,107	777,216	33,945,569
France	2,410,664	7,461,846	59,793	16,845,207
Total	4,154,588	24,399,953	837,009	50,790,776

## 21. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the presentation adopted in the current year.

