

**WELICHEM BIOTECH INC.**  
FORM 51 – 102F1  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED MAY 31, 2005

The following discussion and analysis, prepared as of August 12, 2005, should be read together with the audited financial statements for the year ended May 31, 2005 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts are stated in Canadian dollars unless otherwise indicated.

This Management Discussion & Analysis summarizes the activities of the Company to date, and provides financial information for the year ended May 31, 2005. The discussion contains forward-looking statements that involve risks and uncertainties. Such information is considered reasonable by the Company's management at the time of preparation.

### **Overview**

Welichem Biotech Inc. ("Welichem") is a pioneering Canadian biopharmaceutical company developing proprietary, small molecule drugs with large potential and significant competitive advantages. Our strength lies in our drug discovery and medicinal chemistry capabilities, which involves the application of microbiology, chemistry and biochemistry to generate novel drug candidates with distinct pharmacological properties and therapeutic potential. Currently, we have several distinct drug candidates at various stages of research and development. These are divided into two categories: core product development, which is the focus of the company's major activities and expense and discovery research, which is the focus of our in-house activities.

Welichem's core product development focuses on WBI-1000 compounds, a series of small molecule immunomodulators that target cytokines and mediators in the immune/inflammatory process of animals. The lead candidate, WBI-1001, has been shown to have potential in the treatment of chronic dermatological autoimmune/inflammatory diseases, in particular, psoriasis and eczema. Welichem's discovery research focuses on WBI-2000 compounds, a new series of anticancer compounds that target solid tumors, such as those of the lung, prostate, breast, ovarian and melanoma that are known to be hard-to-treat.

Our lead compound, WBI-1001, is in formal preclinical study for treatment of psoriasis and is on track for review by the Canadian regulatory authorities for Clinical Trial Application (CTA) as the next step of the regulatory approval process. Other compounds for this WBI-1000 series are being evaluated for potential application against other autoimmune diseases (e.g. eczema and inflammatory bowel disease). Concurrently, Welichem's 2000 series of compounds have a strong research focus due to their potential in the treatment of cancer.

On November 1, 2004 Welichem amalgamated with Belltech Ventures Ltd. ("Belltech"), and following reverse takeover procedures this resulted in Welichem Biotech Inc. being the acquired company but having the larger number of shares.

Significantly, in September, 2004 Celestial Pharmaceuticals (Shenzen) Ltd. ("Celestial") invested approximately \$1.5 million in Welichem which was a strong endorsement of the Company's business.

### **2005 Achievements**

- Established formal pre-clinical studies with our lead compound.
- Signed a technology transfer agreement with Celestial.
- Received a significant investment (\$1.5 million) from Celestial.
- Completed a reverse takeover with Belltech so that Welichem became a public company listed on the TSX Venture Exchange on May 25, 2005.
- Completed a private placement of \$1.9 million at the end of May 2005.

### **Vision and Strategy**

Our long-term business strategy is to build upon our internal drug discovery and development capabilities to support the advancement of our most promising therapeutic candidates into clinical trials, and possibly up to clinical Phase II, contingent upon available resources. However, we will seek to partner our drug candidates at various stages of development when additional expertise or resources in clinical development are required and when reasonable terms can be secured.

The more advanced a drug candidate is before partnering, the better positioned the Company should be to negotiate terms. These could include up-front and milestone payments, funding from the partner to cover all or a portion of ongoing development costs, as well as a share of revenues based on net product sales. We may also utilize alliances and strategic partnerships to expand our research, clinical, regulatory and drug development capabilities.

In the short-term, we focus on moving our lead drug candidate, WBI-1001, through preclinical and clinical trials and seeking partnerships that could support and expand its development. WBI-1001 is a small molecule compound which, when formulated in a cream, will be evaluated as a topically applied therapeutic against psoriasis. WBI-1001 was selected as the lead drug candidate based on its bioavailability, stability and apparent potency *in vitro* and in animals without observed side effects. It is anticipated that chemical analogues of WBI-1001 will be explored for consideration against other indications (e.g. inflammatory bowel disease and eczema).

Concurrently, we are working toward identifying new potential indications for other members of the WBI-1000 series of compounds. The WBI-2000 series of compounds have anti-proliferative properties, and selected members of the group are showing encouraging results in animal studies as potential therapeutics against cancer. The objective is to move one of these compounds forward for testing as drug candidate as rapidly as financial resources will allow. In-house research using our Symbiochem™ technology continues to result in unique compounds with bioactivities of promising utility.

### **Partnering and Investment**

In September 2004, the Company signed an agreement with Celestial Pharmaceuticals (Shenzhen) Ltd. ("Celestial") of China, whereby Celestial invested a total of \$1.5 million Canadian dollars in exchange for 6,818,183 post-amalgamation shares in Welichem and 6,818,183 warrants to acquire additional shares at \$0.23 per share until August 31, 2006 and for patent rights in China of Welichem's existing technologies.

In return, this agreement enables Welichem, on a priority basis and at no cost to Welichem, to receive and to use data from any clinical, animal or laboratory tests arising or resulting from work done in China using Welichem's technologies. This agreement provided Welichem with cash and, importantly, quick access to safety and efficacy data which thus minimizes potential risks at the early stages of R&D on Welichem's compounds.

### **Amalgamation**

On November 1, 2004, Belltech Ventures Ltd. ("Belltech") completed the acquisition of Welichem by issuing 17,850,399 common shares in exchange for all the issued and outstanding shares of Welichem. This transaction resulted in the former shareholders of Welichem owning the majority (88%) of the issued and outstanding shares of the combined entity. Accounting principles applicable to reverse take-over have been applied to record this acquisition. Under this basis of accounting, Welichem has been identified as the acquirer, and, accordingly, the combined entity is considered to be a continuation of Welichem.

The Company issued 2,430,000 common shares in exchange for Belltech Ventures Ltd.'s net assets on November 1, 2004.

### **Financing**

From its incorporation in 1995, the Company has financed its operations through private sale of equity securities, and through interest income, refundable investment tax credit and government grants.

In fiscal year 2005, Welichem has closed two financings: on September 8, 2004, the Company issued 6,818,183 units (adjusted for the amalgamation) at a price of \$0.22 per unit to raise gross proceeds of \$1,500,000 in a relation with the Celestial investment. Each unit consisted of one common share and one warrant to purchase one common share at \$0.23 per share until August 31, 2006.

At the end of May 2005, the Company issued 8,449,924 common shares at a price of \$0.23 per share to raise gross proceeds of \$1,943,483 in a private placement.

The Company issued 909,090 common shares through conversion of \$200,000 preferred shares on November 1, 2004.

Welichem will use these funds to complete formal preclinical studies for the initiation of the clinical trials on its anti-psoriasis drug, WBI-1001. Welichem will then raise additional funds to take its drug candidate, WBI-1001, through Phase II.

Parallel studies will investigate the potential of WBI-1001 as a treatment for Eczema and Inflammatory Bowel Disease (IBD), thus further enhancing the value of WBI-1001.

### **Liquidity, Risks Factors and Uncertainties**

The Company's business is in the development stage and does not generate cash flow from operations to adequately fund its activities and has thus relied principally on the issuance of securities for financing. There is no assurance that such financing will be available on a timely basis under terms acceptable to the Company.

It should be noted that the Company's funding needs may vary depending upon several factors, including the progress and nature of research and development initiatives, the ability to attract and maintain strategic alliances, the Company's decision to in-license technology, acquisition and unforeseen costs associated with undertaking pre-clinical/clinical studies.

The Company anticipates that its current funds on hand, the most recent financing from Celestial and others, together with interest income, will be sufficient to fund operations through 2005.

### **Research and Development**

Welichem is a development stage company that dedicates the majority of its resources to research and development activities. During 2005, substantial costs have been incurred as the Company is focused on completing formal preclinical tests of WBI-1001 for the treatment of psoriasis. These formal tests, including major CMC and safety evaluations as required by government regulations, were done under contract by highly reputable research organizations and under strict Canadian and US GLP and GMP guidelines.

The Company expects to continue incurring substantial development expenditures through the remaining calendar months in 2005 and 2006 due to its on going preclinical development and regulatory work.

### **Results of Operations**

As at May 31, 2005, Welichem has not generated any revenue other than interest income, and it is unlikely to be in a position to generate sufficient revenue to meet its ongoing operating and capital expenses for the foreseeable future. Welichem has incurred operating losses since inception.

The net loss for the most recent financial year ended May 31, 2005 was \$1,198,931 (2004-\$226,013) and 6 cents per share (2004- 2 cents per share). This increase in net loss was due to an increase of \$263,789 in administrative expenses and \$591,584 in R&D expenses. The substantial increase in R & D expenses in fiscal year 2005 was due to the increased research and development activities by the Company as it moved forward to completing formal preclinical tests of WBI-1001 for treatment of psoriasis. In addition, substantial contract work was done by contract organizations as required by government regulations.

Administrative expenses for the year were \$458,473 (2004 - \$194,784). Major expenses included: \$135,324 (2004 - \$32,468) in legal and accounting fees due to the reverse take-over transaction; \$56,407 (2004 - \$32,904) in wages and benefits due to an increase in the number of research staff; \$64,551 (2004 - \$4,612) in consulting fees due to hiring of a public relations agent and an increase in financing activities; \$36,674 (2004 - \$7,247) in office and miscellaneous expenses due to an increase in company R & D and financing activities; and \$24,901 (2004 - \$3,805) in travel and related costs due to negotiations with Celestial on the technology transfer agreement and financing terms.

Welichem's financial statements do not include any adjustments to overcome any uncertainty.

### **Related Party Transaction**

A payment of \$3,031 was made to Dr. John North, a director of the Company, for consulting services rendered in the year. There was no other related party transaction.

### **Subsequent Events**

Subsequent to the fiscal year 2005, the Company granted an aggregate of 100,000 stock options to an officer and a consultant. The options, being vested immediately, are exercisable at a price of \$0.23 and \$0.34 per share for a period of five years from the date of granting the options.

## Outstanding Share Data

As of May 31, 2005, the Company had the following outstanding securities:

(1) Common Shares issued	28,730,323
(2) Stock Options	1,906,080
(3) Warrants	6,818,183

	Year Ended May 31, 2002 (Audited)	Year Ended May 31, 2003 (Audited)	Year Ended May 31, 2004 (Audited)	Year Ended May 31, 2005 (Audited)	1 <sup>st</sup> Quarter Ended August 31, 2004 (Unaudited)	2 <sup>nd</sup> Quarter (3 Months) Ended Nov. 30, 2004 (Unaudited)	3 <sup>rd</sup> Quarter (3 Months) Ended Feb. 28, 2005 (Unaudited)
<b>Operation Data</b>							
Government Assistance and Other Subsidies	24,600	235,491	30,590	10,073	0	0	0
SRED Tax Credit	271,531	174,044	119,728	97,778	0	0	0
Other Income	15,109	19,850	49,576	(23,827)	(5,810)	(57,557)	27,503
Research and Development	582,892	563,606	239,430	831,014	68,229	242,724	178,662
General and Administrative Expenses	160,834	178,013	194,784	458,473	49,281	106,388	92,719
<b>Loss for the period</b>	<b>(432,486)</b>	<b>(312,234)</b>	<b>(226,013)</b>	<b>(1,198,931)</b>	<b>(123,320)</b>	<b>(406,669)</b>	<b>(243,878)</b>
<b>Balance Sheet</b>							
Cash	27,908	49,549	216,165	1,384,640	400,796	328,337	296,160
Short Term Investments	335,503	252,769	456,665	875,141	456,665	940,878	959,559
Pre-Paid Expenses	43,275	12,715	12,715	12,715	12,715	13,060	12,715
Receivables	23,104	2,805	49,189	16,586	2,433	15,877	9,529
SRED Tax Credit Receivable	291,687	171,686	119,728	97,778	119,728	119,728	0
Capital Assets	104,118	66,987	48,197	50,524	44,075	48,824	48,769
Patent rights	138,975	182,102	202,433	291,111	203,916	239,802	240,382
Other Assets	13,786	13,879	13,879	13,879	13,879	13,879	13,879
<b>Total Assets</b>	<b>978,356</b>	<b>752,492</b>	<b>1,118,971</b>	<b>2,742,374</b>	<b>1,254,207</b>	<b>1,720,385</b>	<b>1,580,989</b>
Accounts Payable	43,000	29,370	41,545	161,698	34,100	162,884	14,611
Convertible Loan Payable	174,500	174,500	174,500	0	0	0	0
<b>Total Liabilities</b>	<b>217,500</b>	<b>203,870</b>	<b>41,545</b>	<b>161,698</b>	<b>34,100</b>	<b>162,884</b>	<b>14,611</b>
Share Capital	1,552,889	1,792,889	1,967,389	5,238,644	1,967,389	3,360,027	3,360,027
Contributed surplus	0	0	2,950	11,243	2,950	11,243	11,243
Share subscriptions received in advance	0	0	577,367	0	843,368	186,500	439,255
Deficit	(932,033)	(1,244,267)	(1,470,267)	(2,669,211)	(1,593,600)	(2,000,269)	(2,244,147)
<b>Shareholders' Equity</b>	<b>\$760,856</b>	<b>548,622</b>	<b>1,077,426</b>	<b>2,580,676</b>	<b>1,220,107</b>	<b>1,557,501</b>	<b>1,566,378</b>

Note: Quarterly financial information for prior years was not available as the Company was a private company until November 1, 2004.