

WELICHEM BIOTECH INC.
FORM 51 – 102F1
MANAGEMENT DISCUSSION AND ANALYSIS
Year Ended May 31, 2006

The following discussion and analysis, prepared as of September 14, 2006, should be read together with the audited financial statements for years ended May 31, 2006 and 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, 2006. 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 is engaged in the discovery, development and commercialization of pharmaceutical drugs to treat unmet healthcare needs. The Company focuses its resources on developing two groups of lead drug compounds, one targeted on autoimmune / inflammatory diseases and the other on types of cancer. Here are some of the highlights for the last year:

- Positive animal test data continue to support the potential of WBI-2100 as a lead drug candidate against some types of solid tumour cancer.
- Chemical synthesis of WBI-2100 was achieved.
- A rational sequence of animal model tests helped identify a probable mode of action of WBI-2100.
- A detailed review of the formal preclinical data of our lead drug candidate against psoriasis, WBI-1001, was undertaken by expert consultants as a prelude to its submission to the regulatory authorities later this year for approval to enter clinical trials.
- In anticipation of the forthcoming clinical trials of WBI-1001 against psoriasis a supply of the cream vehicle for the compound is being manufactured in cGMP facilities.

Welichem's overall drug development platform is advancing through our own laboratory facilities and through outsourcing to specialist research laboratories. This has the advantage of combining the multiple perspectives of experts familiar with drug manufacture and with the therapies of the disease target with that of processing in selected, high quality laboratory facilities.

The Company requested a detailed preclinical review of its lead drug candidate against psoriasis (WBI-1001) by two expert consultants. This was initiated prior to submission of this drug candidate to the regulatory authorities so as to enable fine-tuning and the identification of any outstanding facets of the preclinical development programme. The few remaining preclinical tests have been scheduled, and the Company is looking forward to the opportunity of moving to clinical trials with this very promising new type of drug candidate as a topical therapy for mild and moderately severe psoriasis.

Welichem's second lead drug compound, WBI-2100, has demonstrated potent effects against several types of human, solid tumour cancers. On-going tests in animal models consistently demonstrate a monotherapeutic effect and a strong synergistic effect against tumours when applied in combination with selected, commonly used, commercial anti-cancer drug therapies. Bio-availability studies indicate that WBI-2100 is suitable for both oral and intravenous administration which would provide a significant advantage in future clinical use. Having achieved synthesis of this promising drug candidate for experimental trials and preclinical testing, the Company is focused now on developing a manufacturing process for synthesizing the compound on a large scale.

The drug development programme has been significantly enhanced by the addition of a senior cell biologist, Dr. Liren Tang, to head our in-house Biological Research Laboratories. Dr. Tang has extensive experience in dermatology, involving both autoimmune and cancer diseases.

Results of Operations

Presently, Welichem has no revenues and it is unlikely to be in a position to generate sufficient revenues to meet its ongoing operating and capital expenses for the foreseeable future. Welichem has incurred operating losses since its inception.

Year ended May 31, 2006 compared to year ended May 31, 2005

The net loss for the year ended May 31, 2006 was \$2,378,867 (2005 - \$1,198,931) and 8 cents per share (2005 - 6 cents per share). The Research & Development Expenses for this year were \$1,719,533 (2005 - \$721,131). Major expenses included \$1,304,790 (2005 - \$497,518) in subcontractors, supplies and materials and \$465,561 (2005 - \$337,996) in wages and benefits. The Company received \$50,818 (2005 - \$10,073) in government assistance and other subsidies and \$ nil (2005 - \$104,310) in research and development tax refund.

Administrative expenses for this year were \$633,547 (2005 - \$453,973). Major expenses included \$93,610 (2005 - \$67,235) in rent, \$229,823 (2005 - \$60,200) in wages and benefits, \$34,288 (2005 - \$17,000) in investor relations, \$10,825 (2005 - \$21,650) in insurance, \$90,950 (2005 - \$135,324) in professional fees, \$32,462 (2005 - \$36,674) in office and miscellaneous expenses, \$30,730 (2005 -

\$24,901) in travel and related costs, \$23,201 (2005 – \$9,500) in regulatory expenses, \$17,490 (2005 – nil) in director’s fees, and \$3,750 (2005 - \$47,551) in consulting fees.

Factors that contributed to higher administrative expenses in 2006 included:

- i) higher regulatory fees and investor relations costs due to its listing on the TSX Venture Exchange as a public company;
- ii) increase in rent due to expanded facility;
- iii) higher wages and benefits due to increase in staff;
- iv) higher stock-based compensation costs; and
- v) higher amortization expenses.

Quarter ended May 31, 2006 (Q4 2006) compared to quarter ended May 31, 2005 (Q4 2005)

The net loss for the three months ended May 31, 2006 was \$754,920 compared to \$425,064 for the same period in 2005, an increase of 78%. The Research & Development Expenses for the three-month period ended May 31, 2006 were \$504,042 (2005 - \$265,453), an increase of 90%. Administrative expenses for this three-month period were \$182,502 (2005 - \$163,355). Major expenses included \$25,979 (2005 - \$22,858) in rent, \$166,537 (2005 - \$9,602) in wages and benefits, \$42,167 (2005 - \$84,217) in professional fees, \$11,349 (2005 - \$19,477) in office and miscellaneous expenses, and \$8,725 (2005 – \$9,500) in regulatory expenses. In Q4 2006, the Company reclassified and allocated the stock-based compensation costs to the R & D wages and also the administrative wages. Thus administrative wages in Q4 2006 included the stock-based compensation costs of \$122,532 compared to \$3,793 for Q4 2005.

Financing

From its incorporation in 1995, the Company has financed its operations through private sale of equity securities, and through interest income, refundable tax credits and government grants. While the Company has no financing activities in this year, it has developed a plan to finance future operations.

The Company did not arrange any financing in 2005-06. However, it has closed a non-broker private placement of 37,536,000 units at a purchase price of \$0.075 per unit, for total gross proceeds of up to \$2,815,200 on July 12, 2006. Each unit consists of one common share and one-half of one share purchase warrant. Each whole warrant is exercisable into one common share at a price of \$0.20 for a period of 24 months from the date of issuance of the share purchase warrant. A finder’s fee of \$255,870 was paid in connection with the private placement. All securities issued under this private placement will have a 6-month hold period expiring on January 12, 2007.

Liquidity

During the year ended May 31, 2006, the Company relied on the proceeds from the non-broker private placement completed in May 2005 to continue its operations and Research and Development activities.

At May 31, 2006, the Company had \$265,593 (2005 - \$1,384,640) in cash and cash equivalents and \$ nil (2005 - \$875,141) in short-term investments. The Company's net working capital position as at May 31, 2006 was \$142,696 (2005 - \$2,225,162).

With its current funds on hand, together with interest income and the Scientific Research and Experimental Development Program (SRED) refund tax credit, and the net proceeds from the recent financing, the Company anticipates that it has sufficient funds for operations to the spring of 2007.

Until the Company achieves the licensing or drug commercialization stages, it will continue to fund its operations from a combination of the sale and issuance of equity securities and government subsidies.

Risks 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.

If adequate funding is not available, the Company may be required to delay, reduce or eliminate one or more of its research and development programs or obtain funds through arrangements with corporate partners or others that may require the Company to relinquish greater or all rights to product candidates at an earlier stage of development or on less favourable terms than the Company would otherwise seek. Insufficient funding may also require the Company to relinquish rights to certain of its technologies that the Company would otherwise develop itself.

Summary of Annual Information

	Year Ended May 31, 2006 (Audited)	Year Ended May 31, 2005 (Audited)	Year Ended May 31, 2004 (Audited)
Total Income	(25,787)	(23,827)	49,576
Loss for the year	(2,378,867)	(1,198,931)	(226,013)
Loss per Common Share - basic and fully diluted	(0.08)	(0.06)	(0.02)
Total Assets	759,574	2,742,374	1,118,971
Total Current Liabilities	289,920	161,698	41,545
Total Long-term Liabilities	0	0	0
Shareholders' Equity	469,654	2,580,676	1,077,426

Summary of Quarterly Information

	4 th Quarter Ended May 31, 2006 (Unaudited)	3 rd Quarter Ended Nov. 28, 2006 (Unaudited)	2 nd Quarter Ended Nov. 30, 2005 (Unaudited)	1 st Quarter Ended August 31, 2005 (Unaudited)	4 th Quarter Ended May 31, 2005 (Unaudited)	3 rd Quarter Ended Nov. Feb. 28, 2005 (Unaudited)	2 nd Quarter Ended Nov. 30, 2004 (Unaudited)	1 st Quarter Ended August 31, 2004 (Unaudited)
Total Income	(68,376)	5,689	2,805	2,512	8,361	27,503	(57,557)	(5,810)
Loss for the period	(754,920)	(306,241)	(630,153)	(687,553)	(425,064)	(243,878)	(406,669)	(123,320)
Loss per Common Share – basic and fully diluted	(0.03)	(0.01)	(0.03)	(0.02)	(0.02)	(0.01)	(0.02)	(0.01)
Total Assets	759,574	1,097,927	1,367,595	1,974,935	2,742,374	1,580,989	1,720,385	1,254,207
Total Liabilities	289,920	18,773	35,826	65,562	161,698	14,611	162,884	34,100
Shareholders' Equity	469,654	1,079,154	1,331,769	1,909,373	2,580,676	1,566,378	1,557,501	1,220,107

Off Balance Sheet Arrangements

The Company is not aware of any material off balance sheet arrangements requiring disclosure.

Related Party Transactions

During the year ended May 31, 2006, the Company paid \$269,734 (2005 - \$234,742) in wages, \$3,750 (2005 - \$3,031) for consulting services, and \$17,490 (2005 - \$ nil) in directors' fees to its former and current officers and directors.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are disclosed in Note 3 to the audited financial statements as at May 31, 2006. Critical accounting policies and estimates include:

Cash equivalents

The Company considers all highly liquid financial instruments with an original maturity of 90 days or less to be cash equivalents. Cash equivalents are recorded at the lower of cost plus accrued interest and market value.

Short-term investments

The Company considers all highly liquid financial instruments with an original maturity greater than 90 days to be short-term investments. Short-term investments are recorded at the lower of amortized cost or market value.

Intangible assets

Intangible assets consist of patent rights and applications costs incurred for the filing of patents. Intangible assets are amortized on a straight-line basis over the maximum period of ten years from the time of acquisition.

Stock-based compensation

The Company uses the fair value method for stock-based compensation granted to employees and non-employees of the Company and all direct awards of stock, in accordance with the CICA Handbook Section 3870 "*Stock-Based Compensation and Other Stock-Based Payments*". The fair value of stock options is determined by the *Black-Scholes Option Pricing Model* with assumptions for risk-free interest rates, dividend yields, volatility factors of the expected market price of the Company's common shares and an expected life of the options. The fair value of direct awards of stocks is determined by the quoted market price of the Company's stock.

Research and development expenses

Research and development costs are expensed as incurred unless such development costs meet the criteria under Canadian generally accepted accounting principles for deferral and amortization. Development costs which meet generally accepted criteria for deferral are capitalized and amortized against earnings over the estimated period of benefit. As at May 31, 2006 and 2005, the Company had not deferred any development costs.

Government assistance and other subsidies

Government assistance and other subsidies are recorded as either a reduction of the cost of the applicable assets or credited in the statement of operations as determined by the terms and conditions of the agreement under which the assistance is provided to the Company.

Research and development tax credits

Refundable tax credits are recorded as either a reduction of the cost of applicable assets or credited in the statement of operations depending on the nature of the expenditures which gave rise to the credits. Claims for tax credits are accrued upon the Company attaining reasonable assurance of collection from the Canada Revenue Agency.

Investment tax credits are accrued on qualifying expenditures when there is reasonable assurance that the credits will be recovered. Research and development tax credits were only available to the Company up to October 31, 2004, prior to amalgamation and becoming a publicly listed entity.

Income taxes

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Subsequent Events

Subsequent to this reporting period, the Company has closed a non-broker private placement of up to 37,536,000 units. See details in “Financing” section above.

On August 31, 2006, the Company granted incentive stock options to its directors, officers, employees, and consultants for the purchase of up to an aggregate of 2,090,000 common shares of the Company at a price of 10 cents per share until August 31, 2011.

Outstanding Share Data

As at September 14, 2006, the Company had the following outstanding securities:

(1) Common Shares issued	66,316,325
(Shares in escrow: 6,627,066)	
(2) Stock Options	5,609,600
(3) Warrants	18,768,000

Additional Information

Additional Information relating to the Company is available on SEDAR (www.sedar.com).