

**WELICHEM BIOTECH INC.**  
**FORM 51 – 102F2**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
Period Ended August 31, 2008

The following discussion and analysis, prepared as of October 26, 2008, should be read together with the Company's audited financial statements for year ended May 31, 2008 and unaudited financial statements for period ended August 31, 2008 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). 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 3-month period ended August 31, 2008. The discussion contains forward-looking statements made by management that involve risks and uncertainties. Such information is considered reasonable by the Company's management at the time of preparation. The actual results may differ materially from those contained in any forward-looking statements.

**OVERVIEW**

Welichem Biotech Inc. ("Welichem" or "the "Company") is dedicated to the discovery, research and development of pharmaceutical drugs for the treatment of unmet medical needs. The Company's prime focus is on the development of drugs for the treatment of autoimmune/inflammatory diseases and cancerous tumours.

The Company is building on its latest success and has now placed a high priority on completing the development of its anti-inflammatory drug candidate, WBI-1001, and also on securing proof of principle of its unique anti-cancer/neutrophil boosting drug candidate, WBI-2100. The timely development of these two drug candidates is the spear head of the Company's business.

**Anti-inflammatory drug candidate, WBI-1001**

The Company has successfully concluded a Phase IIa clinical trial of its WBI-1001 cream on patients with atopic dermatitis (AD), a type of eczema. This was a single-centre, randomized, double blind, vehicle-controlled study, in Canada, to evaluate topically applied WBI-1001 cream in 36 patients with AD on 1% to 10% of the body surface area (BSA). Patients were randomly assigned to one of three treatment groups (0%, 0.5% and 1.0% WBI-1001 cream) and treated twice daily for 28 days.

The primary objective was to assess the safety and tolerability of the topically applied WBI-1001 cream, and the secondary objectives were to explore its efficacy and to assess the systemic exposure and pharmacokinetics (PK) of the WBI-1001 cream, based on its concentration in the patients' blood plasma.

The WBI-1001 cream treatment, at 0.5% and 1.0%, was very well tolerated by the AD patients. There were no serious adverse events, no patient withdrew from the study because of the treatment and only two WBI-1001 cream (at the 1% level) treated patients incurred mild papules. Both of these patients completed the study and continued to apply the WBI-1001 study cream on active AD.

Using standard descriptive pharmacokinetic parameters, analysis of the plasma samples showed that there was more WBI-1001 in the plasma of patients in the first few hours following treatment with the WBI-1001 cream (0.5% and 1.0%) on Day 0 than in the first few hours following treatment on Day 28. There was no accumulation of WBI-1001 in the plasma over time. No WBI-1001 was found in the plasma of any patient treated with the placebo (0%) or in the pre-dose plasma samples of patients treated with any dose level of the cream.

Efficacy of the WBI-1001 cream application, a secondary objective of the study, was assessed using standard scoring indices for AD, but statistical evaluation of these was limited due to the small sample size. At all time points, there was a large decrease in the EASI, SCORAD, IGA and BSA indices on patients treated with the WBI-1001 cream (both dose levels) as compared with the placebo cream. The 1% WBI-1001 cream was superior to the placebo in improvement of AD. The mean EASI score was lower for the 0.5% and 1.0% WBI-1001 creams than for the placebo at each of Day 7, 14, 21 and 28 assessments in the study. The outcome of this study strongly supports proceeding to larger clinical trials.

### **Anti-cancer/neutrophil boosting drug candidate, WBI-2100**

Having satisfactorily developed a GMP synthesis and an intravenous formulation of this novel drug candidate, WBI-2100, the Company's focus is on its molecular mode of action. Certain binding proteins for the drug candidate have been identified and tests are being done to confirm them. Meanwhile, global gene expression profiling is being done to determine the functional pathways mediated by WBI-2100 in cancer cells.

### **Pipeline for Other Drug Compounds**

Welichem enters the new financial year on a sound and encouraging footing based on the results from its clinical trials and from contract and in-house research. The Company is cognizant of the encouraging potential of new applications for the drug candidates in its pipeline.

The Company's long-term strategy includes the continual discovery and development of new drugs for the pipeline that are focused on the treatment of oncological and inflammatory disease indications. The Company may seek future partnering opportunities for its drug candidates provided that reasonable terms can be negotiated for the shareholders and for the advancement of the Company's technology and business.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The Company's audited financial statements and unaudited interim financial statements are prepared in accordance with Canadian GAAP, and the reporting currency is the Canadian dollar. These accounting principles require the Company to make certain estimates and assumptions. Management believes that the estimates and assumptions upon which it relies are reasonable based on information available at the time that these estimates and assumptions are made. Actual results could differ from these estimates. Areas of significant estimates include: amortization of patent rights and applications, assessment of the impairment of patent rights and applications, and stock-based compensation. The significant accounting policies that the Company believes are the most critical in fully understanding and evaluating the reported financial results include the following:

### **Patent rights and applications**

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

### **Stock-based Compensation**

The Company grants stock options to its executive officers, directors, employees and consultants pursuant to a stock option plan described in Note 11 to the audited financial statements as at May 31, 2008. The Company uses the fair value method of accounting for all stock-based awards for 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*, which requires certain assumptions, including risk-free interest rates, dividend yields, future stock price, and an expected life of the options. Changes to any of these assumptions could produce different fair values for stock-based compensation.

## **Financial Instruments and Risk**

The carrying value of cash and cash equivalents, short term investments, Goods & Services tax receivable, accounts payable and accrued liabilities, and shareholder loan approximate their fair value because of the short-term nature of these instruments. The Company is subject to currency risk due to the fluctuation of exchange rates between the Canadian dollar and the foreign currency denominated financial instruments. The Company is not subject to significant interest or credit risks arising from these financial instruments.

## **Research and development expenses**

Research costs are expensed as incurred 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 August 31, 2008 and 2007, 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.

## **Income taxes**

Future income taxes are recorded using the liability method. 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 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.

## **CHANGES IN ACCOUNTING POLICIES**

### **Comprehensive income and equity**

Effective June 1, 2007, the Company adopted the new recommendations of the CICA Handbook Section 1530, “*Comprehensive Income*” and Section 3251, “*Equity*”. The adoption of these Handbook Sections had no significant impact on opening deficit.

- Section 1530 provides standards for reporting and display of comprehensive income, which is the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP.
- Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530.

The adoption of these new Handbook sections had no impact on the financial statements for the period ended August 31, 2008.

### **Financial instruments**

Effective June 1, 2007, the Company also adopted the new recommendations of the CICA Handbook Section 3855, “*Financial Instruments – Recognition and Measurement*” and Section 3861, “*Financial Instruments – Disclosure and Presentation*”. These new accounting standards, which apply to fiscal years beginning on or after October 31, 2006, provide comprehensive requirements for the recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Under the new standards, policies followed for periods prior to the effective date generally are not reversed and, therefore, the comparative figures have not been restated. The adoption of these Handbook Sections had no significant impact on opening deficit.

- Section 3855 requires financial instruments be classified into one of five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. All financial instruments, including derivatives, are measured on the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income.

Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income. Transaction costs are included in the initial carrying amount of financial instruments except for held-for-trading items in which case they are expensed as incurred. Section 3855 also requires that the embedded derivatives be identified and separated from the related host contract and be measured at fair value. Subsequent changes in fair value of embedded derivatives are recognized in the statement of operations in the period the change occurs.

- Section 3861 establishes the requirements for presentation and disclosure of financial instruments and non-financial derivatives.

Upon adoption of these new standards, the Company has classified cash and cash equivalents as held-for-trading, amounts receivable as loans and receivables, and all financial liabilities as other financial liabilities. The adoption of these new Handbook sections had no impact on the financial statements for the period ended August 31, 2008.

### **Accounting changes**

In July 2006, the CICA revised Section 1506, “*Accounting Changes*”, which now requires that: (i) a voluntary change in accounting principles can be made if, and only if, it is required by primary source of Canadian GAAP or the changes result in more reliable and relevant information, (ii) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and (iii) for changes in estimates, the nature and amount of the change should be disclosed. The revised section is effective for the Company’s financial year beginning June 1, 2007 for fiscal year 2008. The adoption of this section does not have an impact on the Company’s financial statements for the period ended August 31, 2008.

### **New accounting pronouncements**

The Canadian Accounting Standards Board (AcSB) issued two new Sections in relation to financial instruments: Section 3862, “*Financial Instruments – Disclosure*”, and Section 3863, “*Financial Instruments – Presentation*”. Both sections would become effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company

adopted these standards commencing June 1, 2008. The adoption of these new standards had no material impact on the Company's financial statements.

The AcSB issued Section 1535, "*Capital Disclosures*". This standard requires disclosure regarding what the Company defines as capital and its objectives, policy and processes for managing capital. This standard will be effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company adopted these standards commencing June 1, 2008. The adoption of these new standards had no material impact on the Company's financial statements.

In January 2006, CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") for accounting periods commencing on or after January 1, 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The new Section will be applicable to the Company's financial statements for its fiscal year beginning June 1, 2009. The Company is currently evaluating the impact of the adoption of this new Section on its financial statements.

## **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. Thus the Company has incurred operating losses since inception.

### **3-Month Period Ended August 31, 2008 compared to the 3-Month Period Ended August 31, 2007**

The net loss for the 3-month period ended August 31, 2008 was \$441,535 (2007 - \$593,104) and 1 cent per share (2007 - 1 cent per share). The Research & Development Expenses for this period were \$295,449 (2007 - \$418,287). Major expenses included \$205,359 (2007 - \$331,944) in subcontractors, supplies and materials and \$121,250 (2007 - \$108,556) in wages and benefits. The Company received \$31,160 (2007 - \$22,213) in government assistance and other subsidies.

Administrative expenses, including stock-based compensation, for this period were \$171,860 (2007 - \$182,297). Major expenses included \$28,827 (2007 - \$25,882) in rent, \$37,472 (2007 - \$78,699) in wages and benefits, \$28,268 (2007 - \$6,823) in regulatory expenses, \$25,091 (2007 - \$3,710) in legal and accounting fees, and \$10,552 (2007 - \$20,753) in insurance.

Factors that contributed to increases for certain administrative expense items for the three-month period ended August 31, 2008 included:

- i) increase in rent due to increase in rental costs per lease agreement.
- ii) increase in regulatory expenses due to private placement financing activities
- iii) increase in legal and accounting fees due to private placement financing activities and patent maintenance.

### **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.

The Company closed a non-brokered private placement of 100,000,000 units at a purchase price of \$0.05 per unit, for total gross proceeds of \$5,000,000. Each unit consisted 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 \$0.10 for a period of 24 months from the date of issuance of the share purchase warrant. The gross proceeds were all received at the current year-end and the finder's fees of \$497,000 were paid in June 2008 in connection with the private placement.

In addition, the Company may seek future partnering opportunities for its product candidates provided that reasonable terms can be negotiated for the shareholders and for the advancement of the Company's technology.

## **LIQUIDITY AND CAPITAL RESOURCES**

During the period ended August 31, 2008, the Company relied on the proceeds from the non-brokered private placements completed in June 2008 to continue its operations and Research and Development activities.

As at August 31, 2008, the Company had a net working capital of \$2,522,463 (2007 - \$350,662) with \$2,657,113 (2007 - \$576,242) in cash and cash equivalents, and \$nil (2007 - \$133,359) in short-term investments.

As stated in Financing Section above, the Company closed a private placement for total gross proceeds of \$5,000,000 in June 2008. The Company has financed its operations to-date primarily through the sale of equity securities. The Company will continue to fund its operations from a combination of the sale and issuance of equity securities and government grants until the Company achieves the licensing or drug commercialization stages.

With its current funds on hand, together with interest income and the funding from the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP), the Company anticipates that it has sufficient funds for operations to early 2009. In addition, the Company is trying to arrange financing to raise additional funds to complete its planned Research and Development programs and to fund its operations.

## **MATERIAL COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

The Company leases lab and office space and is committed to future minimum lease payments as follows:

2008/09	52,852
2009/10	73,848
2010/11	<u>24,616</u>
	<b><u>\$151,316</u></b>

The Company is also committed to paying its share of operating costs in connection with its lab and office space. In addition, the Company has signed agreements and contracts with various contract research organizations (CROs) related to its different research and development projects and will be obliged to

pay \$144,373 to the CROs in the fiscal year 2008-09 when all the work is completed. The Company has not yet signed any agreement or contract with its CROs to provide services beyond fiscal year ending May 31, 2009. Thus there is no CRO obligation shown beyond the fiscal year ending May 31, 2009.

## **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 some 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, 2008	Year Ended May 31, 2007	Year Ended May 31, 2006
Loss for the year	(2,519,988)	(3,201,151)	(2,378,867)
Loss per Common Share -basic and fully diluted	(0.03)	(0.05)	(0.08)
Total Assets	5,389,498	1,763,595	759,574
Total Current Liabilities	1,626,499	463,591	289,920
Total Long-term Liabilities	0	0	0
Shareholders' Equity	3,762,999	1,300,004	469,654

## **SUMMARY OF UNAUDITED QUARTERLY INFORMATION**

	1 <sup>st</sup> Quarter Ended August 31, 2008	4 <sup>nd</sup> Quarter Ended May 31, 2008	3 <sup>rd</sup> Quarter Ended February 29, 2008	2 <sup>nd</sup> Quarter Ended November 30, 2007	1 <sup>st</sup> Quarter Ended August 31, 2007	4 <sup>th</sup> Quarter Ended May 31, 2007	3 <sup>rd</sup> Quarter Ended February 28, 2007	2 <sup>nd</sup> Quarter Ended November 30, 2006
Loss for the period	(441,535)	(817,695)	(618,287)	(490,904)	(593,104)	(689,791)	(812,781)	(831,878)
Loss per Common Share – basic and fully diluted	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)
Total Assets	3,014,478	5,389,498	496,460	789,421	1,094,739	1,763,595	1,066,679	1,998,235
Total Liabilities	190,014	1,626,499	915,767	590,442	404,856	463,591	211,874	470,946
Shareholders' Equity	2,824,464	3,762,999	(419,307)	198,979	689,883	1,300,004	854,805	1,527,289

## **OFF BALANCE SHEET ARRANGEMENTS**

The Company does not have any off balance sheet arrangements requiring disclosure.

## **RELATED PARTY TRANSACTIONS**

In addition to related party transactions disclosed elsewhere in the financial statements, the Company had the following related party transactions during the period:

The Company paid \$47,625 (2007 - \$62,190) in wages and \$3,650 (2007 – \$nil) in directors’ fees to its former and current officers and directors during the period.

The Company repaid a major shareholder the principal amount of \$998,000 (2007 – \$nil) and interest of \$27,521 (2007 – \$nil) accrued during the loan period.

## **SUBSEQUENT EVENTS**

On September 26, 2008, the Company announced the granting of incentive stock options to its directors, officers, employees, and consultants to acquire up to 4,700,000 common shares at an exercise price of \$0.10 for a period of 5 years expiring on September 25, 2013.

## **OUTSTANDING SHARE DATA**

As at October 26, 2008, the Company had the following outstanding securities:

(1) Common shares issued:	173,362,992
(Shares in escrow:	none)
(2) Stock options:	9,864,600
(3) Warrants:	50,000,000

## **DISCLOSURE CONTROLS**

The Company’s Chief Financial Officer and Chief Executive Officer (the “Certifying Officers” are responsible for establishing and maintaining disclosure controls and procedures (“the procedures”) which provide reasonable assurance that information required to be disclosed by the Company under provincial securities legislation (the “Required Filings”) is reported within the time periods specified. Without limitation, the Procedures are designed to ensure that material information relating to the Company is accumulated and communicated to management, including its Certifying Officers, as appropriate to allow for timely decisions regarding the Required Filings.

The Certifying Officers evaluate the effectiveness of the Company's Procedures on a regular basis throughout the year and have concluded that the Procedures in place as of the end of the period covered by the Required Filings are effective in providing reasonable assurance that material information relating to the Company is accumulated and communicated to management and reported within the time periods specified.

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

The Company's Certifying Officers are responsible for establishing and maintaining internal controls over financial reporting ("Internal Controls") and have designed such Internal Controls, or caused them to be designed under their supervision, which provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian GAAP.

Due to the size of the Company, it is not feasible to achieve complete segregation of duties to provide effective controls over financial reporting. In addition, the Company may not have the necessary in-house knowledge to address complex accounting, taxation and legal issues that may arise. These weaknesses and their related risks are not uncommon for a company of the size of Welichem because of limitations in size and number of staff. The Company has implemented internal control policies for over 2 years.

Both the Audit Committee and management review its financial reporting procedures and incorporate further enhancements, when required, to mitigate the risk of any material misstatement in financial reporting.

It should be noted that while the Officers of the Company, as certified in the Company's Annual Filings and as required under Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, have evaluated the effectiveness of these disclosure controls and procedures for the period ended August 31, 2008 and have concluded that they are being maintained as designed, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

### **ADDITIONAL INFORMATION**

Additional Information relating to the Company is available by accessing the SEDAR website at [www.sedar.com](http://www.sedar.com).