

# WELICHEM BIOTECH INC.

## FORM 51 – 102F2

### MANAGEMENT DISCUSSION AND ANALYSIS

Period Ended February 28, 2009

The following discussion and analysis, prepared as of April 16<sup>th</sup>, 2009, should be read together with the Company's audited financial statements for year ended May 31, 2008 and unaudited financial statements for period ended February 28, 2009 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 up to date, and provides financial information for the three months period ended February 28, 2009 ("2009 Q3"). 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 tumors.

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 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 spearhead of the Company's business.

Progress this quarter has clearly demonstrated the rewards of careful planning and financial vigilance in that the two major drug development programs are on schedule and costs are within earlier, pruned estimates.

#### ANTI-INFLAMMATORY DRUG CANDIDATE (WBI-1001)

Building on the successfully completed, 28 day Phase IIa clinical trial of the non-steroid WBI-1001 cream on patients with chronic atopic dermatitis (AD) Welichem has scheduled the definitive 3 month Phase IIb clinical trial on AD patients. As a prelude to this, the Company is currently supplementing its

extensive bioactivity and safety data set of this drug candidate by undertaking the required long-term toxicological animal studies in both rats (subcutaneous application) and minipigs (dermal application). The minipig model is used because the histological structure of the skin is very similar to that of humans. Four, 50kg batches of different WBI-1001 test creams for these animal studies were manufactured, tested for quality, packaged and shipped to laboratories in the USA for use in these studies. Blood plasma samples are being examined during this extended 3 month test period and also at its termination, and histological examination of internal organs will occur at termination.

Significant financial resources have been invested in studies of the molecular mode of action of WBI-1001, and early indications from these studies have lead to the identification of some potential binding proteins. The company is very encouraged by these findings and the next few months could prove to be very rewarding.

AD is a major unmet medical indication, and these positive results are of significance for our overall strategy of developing WBI-1001 for the treatment of this disease and for additional conditions. There is currently no cure for AD, and most common treatments are anti-inflammatory drugs (e.g. corticosteroids) or immunosuppressants (e.g. tacrolimus). AD represents a significant global market that is expected to exceed \$1 billion US by 2010.

#### ANTI-CANCEL/NEUTROPHIL BOOSTING DRUG CANDIDATE (WBI-2100)

The focus on WBI-2100 in this quarter has been primarily to determine its molecular mode of action. The Company's continued progress was rewarded in April 1<sup>st</sup>, 2009 by the further extension and a significant increase in the IRAP award from the National Research Council.

A gene array analysis performed previously to compare changes in gene expression profiling between untreated melanoma cells and those treated with WBI-2100 had revealed several potential functional pathways and their possible associated genes and receptor signaling proteins. Down regulation and up regulation was observed among the selected genes exposed to WBI-2100, and these genes are being examined further in relation to the proven, unique dual-activity of WBI-2100 inhibiting certain cancer cell growth and increasing neutrophil levels. The expression level changes from the micro array study are being verified and PCR analysis undertaken. Four genes associated with melanoma cell death that were upregulated by WBI-2100 have been tentatively identified. As well, another gene that potentially reflects the WBI-2100 neutrophil boosting property has been identified. These studies are being intensively pursued.

#### IND APPLICATION

Significant Company time has been involved in the preparation and submission of an extensive information package to the regulatory authorities of the United States Food and Drug Administration (FDA). This information will be the focus of a meeting (Pre-IND Meeting) next month with US regulatory authorities and be a step towards obtaining Investigative New Drug status for WBI-1001. This action in the US would thus complement similar action by the regulatory authorities of Health Canada.

### COMMUNICATION

Welichem participated and Dr. G. Chen presented in the Annual BioPartnering North America meeting of international biotechnology and pharmaceutical companies held in Vancouver in February 2009. This was one of several forums in recent months where the Company has raised awareness of interested parties to Welichem's drug candidates.

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 cancer and inflammatory diseases. 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.

## INTELLECTUAL PROPERTY

We file patent applications to protect our proprietary discoveries. Patent and patent applications are currently being prosecuted under the following areas:

- Dermatological products (three PCT applications)
- Anticancer Products (two PCT applications)

These applications are designated and/or filed in jurisdictions of major pharmaceutical markets, including Europe, Japan and the US. As with the patent positions of other pharmaceutical, biopharmaceutical and biotechnology firms, we do not know whether any patent applications will result in the issuance of patents or, for patents that are issued, whether they will provide significant proprietary protection or will be circumvented or invalidated.

## 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

## RESULTS OF OPERATIONS

The Company has not generated any revenues in current and previous years other than interest income earned on the Company's cash and cash equivalent accounts. The Company has incurred operating losses since inception, and is unlikely to be

in a position to generate sufficient revenues to meet its ongoing operating and capital expenses for the foreseeable future.

The Company reported a net loss of \$514K in Q3 2009 compared to a net loss of \$616K in Q3 2008. Because the company had 100 million more common shares outstanding in this period (173 mil shares at February 28 09 vs. 73 mil shares at February 28, 2008), its net loss per share in Q3 2009 decreased to \$0.3 cent per share from \$1 cent per share in Q3 2008.

## **Research and Development Expenses**

Research & Development expenses (“R&D”) will generally vary from period to period depending on the scope of clinical development, research programs pursued, stage of clinical trials undertaken, the number of clinical trails that are active during a particular period of time, the rate of patient enrollment, the decisions made to continue the development and on testing a product candidate based on supporting safety and efficacy results from clinical trails.

The R&D expenses in this period decreased \$86K (or 19%) over the comparative period last year (\$356K in Q3 2009 vs. \$442K in Q3 2008). The major decrease in R&D expenses came from the \$56K (or 17%) less subcontracting costs that occurred in this period. Our subcontracting work in this quarter focused on the preparation for WBI-1001 drug product manufacturing, preparation for the Phase IIb animal tests and mode of action research as compared with only the WBI-1001 Phase IIa clinical trial costs during the comparative period last year. The Company is expecting a high volume of subcontracts in the last quarter of 2009 for further Phase IIb animal test evaluations.

In year 2007, the Company was awarded a financial grant of up to \$460K over the period of year 2006 to year 2009 from National Research Council of Canada, Industrial Research Assistance Program (NRC-IRAP). The Company has withdrawn approximately \$30K from this NRC-IRAP award each quarter. In Q3 2008 the Company received \$74K in grant funds from NRC but did not record it until Q4 2008. In Q3 2009 the Company received an additional amount of \$58K from NRC-IRAP. The 2009 YTD grant received from NRC-IRAP totaled \$117K. The remaining of \$10K of IRAP award was received in March 2009 (Q4). On April 1, 2009 the Company was awarded an additional \$93,333 for the period of 2009 to 2010.

The 2009 YTD R&D expenses totaled \$888K representing a \$296K (or 25%) decrease from the \$1,185K incurred during the 2008 YTD comparative period. The decrease was due to the different stage of drug manufacturing, animal test and clinical trial activities for the WBI-1001 product. The 2009 YTD R&D expense is estimated to be slightly higher than 2008 YTD R&D expenses as the Phase IIb animal tests approach at the end of this fiscal year.

## **General and Administrative Expenses**

General and Administrative expenses (“G&A”) increased \$10K (or 5%) over the comparative period last year (\$187K in Q3 2009 vs. \$178K in Q3 2008).

Factors that contributed to increases for certain administrative expense items for this quarter included:

- i) \$39K increase in wages and benefits due to \$26K severance payments to former employees and \$11K of stocked-based compensation accrued.
- ii) \$14K increase in travel expenses to monitor cream manufacturing and animal tests visiting as well as to participate in technical conferences.
- iii) \$10K increase in regulatory fees in respect of options granted in this quarter.
- iv) \$15K decrease in consulting fees as we stopped consulting contracts in this quarter.
- v) \$14K decrease in office expenses partly due to tightened expense control this year and partly because \$9K of travel expenses was misclassified as office expenses in the prior year.
- vi) \$12K decrease in rental costs as our office space was reduced to two-third, starting from January 2009.

The 2009 YTD G&A expenses also increased \$78K (or 15%) to \$614K from \$535K incurred during the 2008 YTD comparative period. The major increase came from financing activity related legal and regulatory costs, patent maintenance legal costs, public relation costs and annual auditing fees. YTD G&A wages and benefits increased slightly by \$11K as the Company paid \$40K of severance fees offset by a \$28K decrease of wages and benefits from reducing administrative employees this year. Our average G&A headcount went down from 4 persons last year to 3 persons this year.

## **Interest Income**

Interest income increased \$24K in Q3 2009 over Q3 2008 and \$62K in 2009 YTD compared to 2008 YTD. The increase in interest income was directly attributable to fair market value change of interest bearing short-term investments.

### Foreign Exchange Gain or (Loss)

The Company maintains a minimal amount of USD dollars in its bank account and needs periodically to buy USD dollars to pay for some of the subcontracting work done in USA. For Q3 2009, no USD dollars were bought compared to \$88K of USD dollars in Q3 2008. The increased USD/CND exchange rate (1.2351 in Q3 2009 vs. 1.0044 in Q3 2008) caused a \$0.3K foreign exchange gain in Q3 2009 versus \$0.5K loss in Q3 2008.

The YTD USD purchase in 2009 was \$122K over \$185K in 2008. The Company recorded \$4K gain this year compared to \$6K loss last year when the average USD/CND rate increased from 1.0172 in 2008 to 1.1390 in 2009.

### SUMMARY OF UNAUDITED QUARTERLY INFORMATION

	3 <sup>rd</sup> Quarter Ended February 28, 2009	2 <sup>nd</sup> Quarter Ended November 30, 2008	1 <sup>st</sup> Quarter Ended August 31, 2008	4 <sup>th</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
Loss for the period	(514,031)	(457,124)	(441,535)	(817,695)	(618,287)	(490,904)	(593,104)	(689,791)
Loss per Common Share – basic and fully diluted	(0.003)	(0.002)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Total Assets	2,231,932	2,509,189	3,014,478	5,389,498	496,460	789,421	1,094,739	1,763,595
Total Liabilities	342,422	141,850	190,014	1,626,499	915,767	590,442	404,856	463,591
Shareholders' Equity	1,889,509	2,367,339	2,824,464	3,762,999	(419,307)	198,979	689,883	1,300,004

### LIQUIDITY AND CAPITAL RESOURCES

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.

In June 2008 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.

As of February 28, 2009, the Company had a net working capital of \$1,612,498 (May 31 2008 - \$3,448,782) with \$1,884,812 (May 31 2008 - \$4,984,241) in cash and cash equivalents.

With its current funds on hand, together with interest income and the funding from the NRC-IRAP, the Company anticipates that it has sufficient funds for operations, research and development to the summer of 2009.

The Company is trying to arrange financing to raise additional funds to complete its planned Research and Development programs through sale of equity securities, issuance of debt and other feasible activities.

#### MATERIAL COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The Company renegotiated the lab and office lease contract in December 2008 and reduced office space by one-third, starting from January 2009. The lab and office space minimum lease payment commitments are shown as follows:

March 2009 to May 2009	20,256
June 2009 to March 2010	<u>67,520</u>
	<b><u>\$87,776</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 \$1,519,941 to the CROs in the fiscal year of 2009 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.

## 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 paid \$52,512 (2008 Q3 - \$36,042) in wages and \$4,000 (2008 Q3 - \$4,500) in directors' fees to its former and current officers and directors during this 3 month period.

The Company repaid a former major shareholder the principal amount of \$998,000 and accrued interest of \$27,521 in Q1 2008.

## CHANGES IN ACCOUNTING POLICIES

### **Capital Disclosure**

Effective June 1, 2008, the Company adopted the new recommendations of the CICA Handbook Section 1535, "*Capital Disclosure*". This new accounting standard establishes the requirement for disclosing information about an entity's capital and how it is managed. Section 1535 requires the disclosure of (i) an entity's objectives, policies, and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirement; and if it has not complied, the consequences of such non-compliance. The adoption of these Handbook Sections had no significant impact on the operating deficit.

Section 1535 relates to only disclosure and presentation, and has no impact on our financial results for the period ended February 28, 2009.

### **Financial instruments – Disclosure and Presentation**

Effective June 1, 2008, the Company also adopted the new recommendations of the CICA Handbook Section 3862, "*Financial Instruments – Disclosure*", and Section 3863, "*Financial Instruments – Presentation*". These new accounting standards provide enhanced and expanded disclosure requirements to complement the changes in accounting policy adopted on June 1, 2007 in accordance with

Section 3855 “*Financial Instruments – Recognition and Measurement*”, and Section 3861, “*Financial Instruments – Disclosure and Presentation*”.

Section 3862 and Section 3863 relate to only disclosure and presentation, and have no impact on our financial results for the period ended February 28, 2009.

## 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 application costs include the acquisition costs and costs incurred in the filing of patents. Patent rights and applications are amortized on a straight-line basis over a 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 the expected life of the options. Changes to any of these assumptions could produce different fair values for stock-based compensation.

## **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 February 28, 2009, 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.

## NEW ACCOUNTING PRONOUNCEMENTS

### **International Financial Reporting Standards**

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.

## **Goodwill and Intangible Assets**

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.

## **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 favorable 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.

## **SUBSEQUENT EVENTS**

On April 6th, 2009 the shareholders of the Company approved to consolidate all of the issued and outstanding Common Shares on the basis of one post-consolidation Common Share for every ten pre-consolidation Common Shares. Each option, warrant, or other securities of the Company convertible into pre-consolidation Common Shares that have not been exercised or cancelled prior to

the implementation of the Share Consolidation will be adjusted pursuant to the terms thereof on the basis of one post-consolidation Common Share for every ten pre-consolidation Common Shares (i.e. the number of Common Shares issuable will decrease while the exercise price will increase). The actual consolidation time is still pending on management decision.

#### OUTSTANDING SHARE DATA

As of April 16, 2009, the Company had the following outstanding securities:

(1) Common shares issued:	173,362,992
(Shares in escrow:	none)
(2) Stock options:	9,204,600
(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 February 28, 2009 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).