



*From Nature's Wonders to Smart Drugs*

# 2007 Annual Report

As a cost saving measure, this Annual Report has been printed in black and white.  
A full colour version can be downloaded from our website at [www.welichem.com](http://www.welichem.com)

## Corporate Profile

Welichem Biotech Inc. (“Welichem” or “the Company”) is a publicly traded company (TSX Venture Exchange, TSX-V: WBI) engaged in the discovery, development, and commercialization of pharmaceutical drugs, through its SYMBIOCHEM® technology platform. From natural origins (nematode-bacterial symbiotic relationships), the Company has developed smart drugs (fully synthesized, small molecule pharmaceutical drug candidates with high efficacy and low toxicity) primarily for the treatment of autoimmune/inflammatory diseases and cancer. Welichem’s lead drug candidate, WBI-1001, is now undergoing Phase I Clinical Trials on psoriasis patients in Canada. Another promising drug candidate, WBI-2100, is undergoing preclinical studies as a novel anti-cancer agent that also mitigates some of the worst side-effects of chemotherapy. Welichem’s pipeline of drug candidates targets global markets worth more than \$70 billion per year.

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## Scientific and Clinical Advisory Boards

Welichem has established a Scientific and Clinical Advisory Board comprised of scientific and clinical experts in the areas of autoimmune/ inflammatory diseases, cancer, infectious diseases and chemistry. The current members of the Scientific and Clinical Advisory Board are:

**Moulay Alaoui-Jamali, Ph.D.** Professor of Oncology, McGill University. As a recognized authority in cancer research, Dr. Alaoui-Jamali has expertise in tumor biology, cancer pharmacology, experimental therapeutics, and cancer target discovery. He has been serving on several scientific panels and research committees, including CIHR, NCIC, and the College of Reviewers for the Canada Research Chair Program. Dr. Alaoui-Jamali received his Ph.D. in Molecular Cancer Pharmacology from the National Cancer Institute and René-Descartes University and Faculty of Medicine Lariboisière-Saint-Louis (Sorbonne), Paris, France in 1986.

**Jan Dutz, M.D.** Dr. Jan Dutz received his MD degree from Queen's University, Ontario. He is an Associate Professor in the Department of Dermatology and Skin Sciences of the University of British Columbia with appointments in Divisions of Dermatology and Rheumatology. He has a special clinical interest in the cutaneous manifestations of autoimmune diseases. He is a staff research scientist at the British Columbia's Research Institute for Children's and Women's Health with a research focus on the skin's role in modulating the immune system.

**Robert E.W. Hancock, Ph.D.** *Medical Research Council of Canada, Distinguished Professor, Department of Microbiology and Immunology, University of British Columbia.* Dr. Hancock is an officer of the Order of Canada and a Fellow of the Royal Society of Canada. He was the founding Scientific Director of the Canadian Bacterial Diseases Network and became Head of the UBC Centre for Microbial Diseases and Immunity Research in 1997. Dr. Hancock received his Ph.D. from the University of Adelaide.

**Julia Levy, Ph.D.** *Past President and Chief Executive Officer, QLT Inc.* Dr. Levy was a founding scientist and business associate of QLT. Dr. Levy is an Officer of the Order of Canada, a Fellow of the Royal Society of Canada and a former President of the Canadian Federation of Biological Sciences. Dr. Levy received a Ph.D. in Immunology from the University of London.

**Brian Leyland-Jones, M.D.** *Professor of Oncology, McGill University.* Dr. Leyland-Jones was the founding Chairman of the Department of Oncology at McGill University and is the Director of the McGill Comprehensive Cancer Centre. He is also a physician at Montreal General Hospital, Royal Victoria Hospital and St-Mary's Hospital in Montreal. Dr. Leyland-Jones obtained his medical training and degree from St. Mary's Hospital, University of London.

**Daniel N. Sauder, M.D.** *Professor and Chairman of Department of Dermatology, Johns Hopkins University School of Medicine.* Dr. Sauder is a Fellow of the American Society for Clinical Investigation and founding Editor of the *Journal of Cutaneous Medicine and Surgery*. He was previously Chief of the Division of Dermatology, University of Toronto, and Head of the Clinical Division of Dermatology at Sunnybrook Health Science Centre. Dr. Sauder is a past president of the Canadian Dermatology Association and a past and founding President of the Canadian Society for Investigative Dermatology. Dr. Sauder received his M.D. from McMaster University.

**Keith N. Slessor, Ph.D.** *Professor of Chemistry, Simon Fraser University.* Dr. Slessor is an internationally recognized organic chemist with research interests in the isolation, identification, synthesis and applications of insect semiochemicals. He has received many awards including the Gold Medal from the Science Council of British Columbia in 1992 and Ernest C. Manning Innovation Award of Distinction in 1997. Dr. Slessor received a PhD in Organic Chemistry from the University of British Columbia.

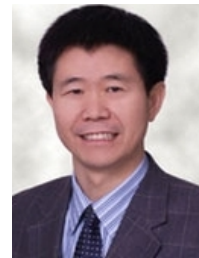


## Letter to Shareholders

It is our pleasure to report to you that Welichem has had a very successful year and one of which we can be justifiably proud. Over the past year, Welichem has made significant advances in its research and drug development programs. In the space of a few months the Company's lead drug candidate against psoriasis has been given regulatory approval and now is in Phase 1 clinical trials. As well, our novel anti-cancer compound has demonstrated immune system stimulating properties, in addition to its cancer-fighting properties. As we strive to expand our product pipeline that targets global markets worth more than \$70 billion per year, we further add resources and capabilities to our business.



Hugh Wynne-Edwards  
Chairman



York Yingping Guo  
Chief Executive Officer

Improving the lives of patients is regarded as the ultimate good of our research and development programs. Welichem's progress this year has advanced the Company significantly towards achieving that goal by continuing to focus on the productivity and efficiency of our internal processes, and by enhancing in-house progress through agreements with corporate and academic teams and individual professionals in Canada and internationally. The core strength of the Company, however, is the creativity, dedication and determination of the internal team, which has enabled the Company to overcome obstacles and to identify and seize appropriate opportunities.

It was especially gratifying to us this year that our Canadian Clinical Trial Application was filed ahead of schedule and that, subsequently, we were able to announce to our colleagues in Welichem, and to our shareholders that our lead compound, WBI-1001, had received regulatory approval to proceed to clinical trials as a topical treatment against psoriasis. We moved into Phase I clinical trials in Quebec in early August. These trials are proceeding well and, to date, no adverse side effects have been encountered.

The lead anti-cancer compound, WBI-2100, which we reported on last year, has proved to be even more interesting and to have even greater pharmaceutical potential than originally thought. This novel, small molecule compound has been shown to not only inhibit the growth of cancerous tumours but also stimulate the immune system. Most chemotherapies destroy the human body's natural defence systems, resulting in life-threatening conditions. In mouse models our compound has prevented weakening of the immune system by stimulating the blood neutrophils following treatment by cancer chemotherapeutics. Welichem and our partner, Celestial Pharmaceuticals (Shenzhen) Ltd. of China, believe that WBI-2100 shows great promise as a treatment to boost the immune system concurrent with or following chemotherapeutic treatments for cancer.



As we focus on moving our lead drug candidates forward the rest of our pipeline is not neglected. Welichem is also developing compounds targeting the treatment of eczema and inflammatory bowel disease. Selective development of further compounds in our pipeline continues.

Welichem has initiated monthly newsletters to better communicate with our shareholders, the biotech investment community and the pharmaceutical industry. Enhancing investor relations will be our focus in the coming year. In order to expand our corporate and business development unit, the Company has hired Dr. Yan Chen to fill the newly created position of Manager of Business Development. Not only does Dr. Chen have her MBA but she also holds a Ph.D. degree in Life Sciences. Dr. Chen is working closely with senior management to develop and execute Welichem's ambitious business plan.

The Company anticipates that executing our Phase I and II clinical trials for WBI-1001 in Fiscal Years 2007-08 and 2008-09 will deliver substantial value to shareholders. Welichem intends thereafter to license its technologies to a major pharmaceutical company for upfront and milestone payments followed by ongoing royalties. In addition, the Company will enhance its value by continuing to develop other potential drug compounds in the pipeline and by exploring other business opportunities.

We look forward to meeting our milestones and to an even a more challenging and rewarding year in 2008.

Respectfully,

Hugh Wynne-Edwards  
*Chairman*

York Yingping Guo  
*President & CEO*



## **New Chemotherapies for Changing Times**

The demands for improved healthcare are increasing worldwide as population size, quality of life and life expectancy increases. There continue to be many diseases and health conditions that are not effectively managed, often because there are no therapies and medicines to do so, or existing resources are ineffective. It is some of these challenges to society that Welichem Biotech is seeking to address, one piece at a time, in its pharmaceutical drug development program.

Welichem's lead candidate, WBI-1001, which is now in clinical trials for the topical treatment of mild to moderate psoriasis, is targeting many millions of people who suffer pain, discomfort, and the psychological and economic hardship of this debilitating disease. Welichem's multi-functioning drug candidate should rapidly improve the appearance of psoriatic skin by diminishing inflammation and inhibiting skin cell proliferation; the result is significant relief for the patient.

The treatment of cancer is likely to change radically as newer, targeted therapies replace broader spectrum treatments. Such drugs will be less toxic, better tolerated and provide better patient outcomes. Welichem Biotech is among those biotech companies that are developing lead candidates with these properties. Welichem's lead cancer compound, WBI-2100, is targeted against solid tumours both as a monotherapy and in combination with other chemotherapeutic drugs. As well, this novel compound has been shown to increase the number of blood neutrophils following treatment of mouse models with the cancer drug, cyclophosphamide, suggesting a significant potential for this drug compound in the prevention of chemotherapy-induced weakening of the immune system, known as neutropenia. Not only does WBI-2100 increase the effectiveness of anti-cancer remedies, and inhibit cancer growth and metastasis itself, it may well prove to reduce some of the most life-threatening side effects of chemotherapy.

Welichem's ultimate success will be dependent on continually developing promising drug candidates that are better than the last generation of medicines, and that offer improved results for patients. By so doing, Welichem will help overcome disease problems associated with aging and with the stress and pollution of large, urban communities.



## WELICHEM BIOTECH INC.

### FORM 51 – 102F1

#### MANAGEMENT DISCUSSION AND ANALYSIS

Year Ended May 31, 2007

The following discussion and analysis, prepared as of September 25, 2007, should be read together with the Company's audited financial statements for years ended May 31, 2007 and 2006 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, 2007. 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" or "the Company") is focused on the discovery and development of pharmaceutical drugs to treat unmet healthcare needs. Using our SYMBIOCHEM® technology platform, the Company develops smart drugs (fully synthesized, small molecules from natural origins) with high efficacy and low toxicity that are targeted primarily at autoimmune/inflammatory diseases and cancer. The Company continues to focus on the productivity and efficiency of our processes to ensure that drug candidates in our pipeline are developed as quickly as possible and meet the regulatory requirements.

Welichem has enhanced its in-house research and development by entering into specific arrangements and agreements with corporate and academic teams and individual professionals at locations across Canada and abroad. These alliances have brought valuable technologies and diverse experience to bear with due regulatory rigor on the development of our drug candidates and have enabled significant milestones to be achieved in the current financial year.

Here are some of the highlights for the year:

- \* Clinical Trial Application for WBI-1001 was made ahead of schedule.
- \* Phase I Clinical Trial of WBI-1001 commenced on August 2, 2007.
- \* Novel anti-cancer, drug compound, WBI-2100, inhibited metastasis in animal model trial.
- \* National Research Council awarded Welichem additional financing to help develop WBI-2100 as a pharmaceutical drug.
- \* WBI-2100 stimulated the mouse immune system, seen as increased blood neutrophils, during treatment with a cancer chemotherapeutic.



## **WBI-1001 Targets Psoriasis**

The Clinical Phase I trial of this remarkable drug candidate, WBI-1001, targeted as a topical cream treatment for mild and moderate forms of psoriasis, which are experienced by 80% of psoriasis sufferers, is proceeding on schedule after the successful culmination of preclinical trials. Following the final auditing of the drug product the Clinical Trial Application for WBI-1001 was made ahead of schedule in early June, 2007, and regulatory approval enabled the Phase I Clinical Trial of WBI-1001 to commence in early August, 2007.

This drug candidate selectively modulates the cytokine cascade resulting in the rapid diminution of skin inflammation and inhibition of keratinocyte proliferation, both of which are fundamental to and characteristics of psoriasis. The Company's topical cream formulation of WBI-1001 is developed for treating the most common form of this disease, plaque psoriasis, for which there is, as yet, no effective cure.

## **WBI-2100 Targets Cancer**

This novel, small molecule drug compound has an array of physical and chemical properties that together with demonstrated biological attributes support its development as a unique chemotherapeutic for the treatment of cancerous tumours. Completed *in vitro* tests have shown that it actively induces apoptosis and inhibits angiogenesis (vascular network formation). In animal tests, WBI-2100 not only inhibited tumour growth and tumour metastasis but also increased the number of neutrophils circulating in the blood. These cancer inhibiting properties and the associated ability to stimulate the body's immune system strongly suggest that WBI-2100 be developed as a chemotherapeutic treatment of cancer, probably as a companion drug with other chemotherapeutics in view of its demonstrated synergistic effect.

The number of neutrophils in the blood of mice was significantly increased following daily doses of WBI-2100 in the presence or absence of the chemotherapeutic, cyclophosphamide. This suggests a significant potential for this drug compound in the prevention of chemotherapy-induced neutropenia, a potentially life-threatening side-effect of chemotherapy.

## **Pipeline for Other Targets**

Eczema, primarily a childhood disease of the skin, is an additional target for WBI-1001. Results from preliminary tests against eczema are leading to consideration of further trials of this drug candidate for its use as a topical treatment of eczema.

Inflammatory bowel disease (IBD), another autoimmune disease characterized by inflammation, is a potential target for treatment by WBI-1001. Initial animal tests have provided encouraging results and these are being followed by additional, focused trials.



## **Company's Profile**

Welichem's success in identifying the dual activity of its WBI-2100 drug compound was further enhanced by an extension of the R & D financial contribution of the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP). This award supports the current focus of Welichem in developing the immune strengthening properties of this drug compound.

Welichem's progress in the development of its pipeline of drugs from the research bench to clinical trials has been reported in scientific publications and in presentations to a range of national and international scientific and pharmaceutical meetings.

Welichem will continue to develop lead compounds for its pipeline through its SYMBIOCHEM® technology platform where the screening for disease targets in the area of cancer, auto-immune diseases and infectious diseases occurs.


## **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 inception.

### **Year ended May 31, 2007 compared to year ended May 31, 2006**

The net loss for the year ended May 31, 2007 was \$3,201,151 (2006 - \$2,378,867) and 5 cents per share (2006 - 8 cents per share). The Research & Development Expenses, including stock-based compensation, for this year were \$2,271,012 (2006 - \$1,719,533). Major expenses included \$1,858,069 (2006 - \$1,304,790) in subcontractors, supplies and materials and \$570,539 (2006 - \$465,561) in wages and benefits, including stock-based compensation. The Company received \$157,596 (2006 - \$50,818) in government assistance and other subsidies. The main reason for the increase in Research & Development Expenses is the increase in research & development activities leading to Clinical Trial Phase I for psoriasis and expenses incurred for developing anti-cancer drug compound, WBI-2100.

Administrative expenses, including stock-based compensation, for this year were \$976,176 (2006 - \$633,547). Major expenses included \$96,197 (2006 - \$93,610) in rent, \$485,896 (2006 - \$229,823) in wages and benefits, \$26,293 (2006 - \$10,825) in insurance, \$90,963 (2006 - \$90,950) in legal and accounting fees, \$46,751 (2006 - \$32,462) in office and miscellaneous expenses, \$80,352 (2006 - \$30,730) in travel and related costs, \$29,624 (2006 - \$23,201) in regulatory expenses, \$18,003 (2006 - \$17,490) in director's fees, and \$42,652 (2006 - \$3,750) in consulting fees.



Factors that contributed to higher administrative expenses in 2007 included:

- i) increase in wages and benefits due to addition of staff and higher stock-based compensation costs allocated to wages & benefits.
- ii) increase in insurance due to additional R & D activities.
- iii) increase in office expenses due to more staff and business activities.
- iv) higher travel costs due to attendance of several conferences by R & D staff and meetings with researchers related to Clinical Trial Phase I.
- v) increase in consulting fees due to hiring of consultants for investor relations and corporate development.

**Quarter ended May 31, 2007 (Q4 2007) compared to quarter ended May 31, 2006 (Q4 2006)**

The net loss for the three months ended May 31, 2007 was \$689,791 (2006 - \$754,920) and 1 cent per share (2006 - 3 cents per share). The Research & Development Expenses, including stock-based compensation, for this three-month period ended May 31, 2006 were \$412,543 (2006 - \$504,042). Administrative expenses, including stock-based compensation, for this three-month period were \$278,119 (2006 - \$182,502). Major expenses included \$15,660 (2006 - \$25,979) in rent, \$138,119 (2006 - \$166,537) in wages and benefits, \$44,530 (2006 - \$42,167) in legal and accounting fees, \$17,376 (2006 - \$11,349) in office and miscellaneous expenses, \$30,490 (2006 - \$5,081) in travel and related costs, and \$12,021 (2006 - \$3,750) in consulting fees.

**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 37,536,000 units at a purchase price of \$0.075 per unit, for total gross proceeds of \$2,815,200 in the first quarter of this fiscal year. 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 \$0.20 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.

Subsequent to May 31, 2007, the Company closed a non-brokered private placement of 6,666,667 shares at a purchase price of \$0.15 per share, for a total of \$1,000,000, which was received prior to May 31, 2007. A finder's fee of \$66,842 was paid in connection with this private placement.



### **Liquidity and Capital Resources**

During the year ended May 31, 2007, the Company relied on the proceeds from the non-brokered private placements completed in the prior years to continue its operations and Research and Development activities.

As at May 31, 2007, the Company had a net working capital of \$965,834 (2006 - \$142,696) with \$1,081,378 (2006 - \$265,593) in cash and cash equivalents and \$133,077 (2006 - \$nil) in short-term investments. The increase of \$823,138 in net working capital from May 31, 2006 was attributable to the advanced subscription payments from subscribers for the private placement closed on June 7, 2007.

As stated in Financing Section above, the Company closed a private placement for total gross proceeds of \$2,815,200 in July 2006 and another private placement for total gross proceeds of \$1,000,000 in early June 2007. 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 the end of December 2007. 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:

2007/08	\$64,460
2008/09	70,228
2009/10	73,848
2010/11	<u>24,616</u>
	<b><u>\$233,152</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 \$420,744 to the CROs in the fiscal year 2007-08 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, 2008. Thus there is no CRO obligation shown beyond the fiscal year ending May 31, 2008.

**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, 2007	Year Ended May 31, 2006	Year Ended May 31, 2005
Loss for the year	(3,201,151)	(2,378,867)	(1,198,931)
Loss per Common Share -basic and fully diluted	(0.05)	(0.08)	(0.06)
Total Assets	1,763,595	759,574	2,742,374
Total Current Liabilities	463,591	289,920	161,698
Total Long-term Liabilities	0	0	0
Shareholders' Equity	1,300,004	469,654	2,580,676

## Summary of Unaudited Quarterly Information

	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	1 <sup>st</sup> Quarter Ended August 31, 2006	4 <sup>th</sup> Quarter Ended May 31, 2006	3 <sup>rd</sup> Quarter Ended Nov. Feb. 28, 2006	2 <sup>nd</sup> Quarter Ended Nov. 30, 2005	1 <sup>st</sup> Quarter Ended August 31, 2005
Loss for the period	(689,791)	(812,781)	(831,878)	(866,701)	(754,920)	(306,241)	(630,153)	(687,553)
Loss per Common Share – basic and fully diluted	(0.01)	(0.01)	(0.02)	(0.03)	(0.03)	(0.01)	(0.03)	(0.02)
Total Assets	1,763,595	1,066,679	1,998,235	2,588,236	759,574	1,097,927	1,367,595	1,974,935
Total Liabilities	463,591	211,874	470,946	232,001	289,920	18,773	35,826	65,562
Shareholders' Equity	1,300,004	854,805	1,527,289	2,356,235	469,654	1,079,154	1,331,769	1,909,373

The major change in shareholders' equity at year end 2007 (compared to year-end 2006) is due to the receipt of subscription advance for the private placement, which was closed in June 2007.

### Off Balance Sheet Arrangements

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



## **Related Party Transactions**

During the year ended May 31, 2007, the Company paid \$267,118 (2006 - \$269,734) in wages, \$nil (2006 - \$3,750) in consulting services, and \$18,003 (2006 - \$17,490) in directors' fees to its former and current directors and officers.

As at May 31, 2007, the Company has a non-interest bearing payable of \$25,000 (2006 - \$nil) owed to a director of the Company.

## **Subsequent Events**

Subsequent to May 31, 2007, the Company closed a non-broker private placement of 6,666,667 shares at a purchase price of \$0.15 per share, for total gross proceeds of \$1,000,000, which was received prior to May 31, 2007. A finder's fee of \$66,842 was paid in connection with this private placement.

## **Outstanding Share Data**

As at September 25, 2007, the Company had the following outstanding securities:

(1) Common shares issued:	73,362,992
(Shares in escrow:	3,313,537)
(2) Stock options:	6,234,600
(3) Warrants:	18,768,000

## **Critical Accounting Policies and Estimates**

The Company's audited financial statements and unaudited interim financial statements are prepared in accordance with Canadian generally accepted accounting principles (Canadian "GAAP") and the reporting currency is Canadian dollar. These accounting principles require the Company to make certain estimates and assumptions. The Company 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 intangible assets, assessment of the carrying value of intangible assets, 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:



## **Intangible assets**

Intangible assets consist of patent rights and applications 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 10 to the audited financial statements as at May 31, 2007. 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**

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying value of cash, short term investments, accounts receivable, Goods & Services tax receivable, and accounts payable 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 May 31, 2007 and 2006, 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**

Research and development 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. Refundable 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 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.

## **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 year ended May 31, 2007 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 on the website of SEDAR ([www.sedar.com](http://www.sedar.com)).



**WELICHEM BIOTECH INC.**  
(a development stage enterprise)

**FINANCIAL STATEMENTS**

**MAY 31, 2007 and 2006**



## AUDITORS' REPORT

To the Shareholders of  
**Welichem Biotech Inc.**

We have audited the balance sheets of **Welichem Biotech Inc.** as at May 31, 2007 and 2006 and the statements of operations and deficit and cash flows for the years then ended. These 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 financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2007 and 2006 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*Ernst & Young LLP*

Vancouver, Canada,  
August 15, 2007

Chartered Accountants

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
BALANCE SHEETS (See Note 1 – BASIS OF PRESENTATION)  
(Expressed in Canadian Dollar)  
AS AT MAY 31

	2007	2006
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents [Note 4 (a)]	\$ 1,081,378	\$ 265,593
Short-term Investments [Note 4(b)]	133,077	-
Subscription receivable	25,000	-
Goods and Services Tax Receivable	159,396	42,111
Research and development tax credits	-	97,778
Prepaid expense	<u>30,574</u>	<u>27,134</u>
	1,429,425	432,616
<b>Property and equipment</b> [Note 5]	29,615	32,804
<b>Patent rights and applications</b> [Note 6]	289,940	279,539
<b>Deposit</b> [Note 7]	<u>14,615</u>	<u>14,615</u>
Total Assets	\$ 1,763,595	\$ 759,574

**LIABILITIES AND SHAREHOLDERS' EQUITY**

<b>Current</b>		
Accounts payable and accrued liabilities	\$ 463,591	\$ 289,920
<b>Shareholders' equity</b>		
Share Capital [Note 8]	7,061,128	5,238,644
Share Subscriptions received in advance [Note 18]	998,125	0
Contributed surplus [Note 9]	1,489,980	279,088
Deficit	<u>(8,249,229)</u>	<u>(5,048,078)</u>
	<u>1,300,004</u>	<u>469,654</u>
Total Liabilities and Shareholder's Equity	\$ 1,763,595	\$ 759,574

**Nature of operations** [Note 2]

**Commitments** [Note 17]

**Subsequent events** [Note 18]

**On behalf of the Board:**

\_\_\_\_\_  
*"John Dustan"* Director      \_\_\_\_\_  
*"Hugh Wynne-Edwards"* Director

The accompanying notes are an integral part of these financial statements.

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**STATEMENTS OF OPERATIONS AND DEFICIT**  
(Expressed in Canadian Dollar)  
YEARS ENDED MAY 31

	2007	2006
<b>RESEARCH AND DEVELOPMENT EXPENSES</b> [Notes 10, 12 & 13]	<u>\$ 2,271,012</u>	<u>\$ 1,719,533</u>
<b>GENERAL AND ADMINISTRATIVE EXPENSES</b>		
Amortization – Property and equipment	11,613	30,736
Amortization – Patent rights and applications	37,752	29,482
Consulting [Note 19]	42,652	3,750
Director’s Fees [Note 19]	18,003	17,490
Insurance	26,293	10,825
Investor Relations	4,441	34,288
Legal and accounting fees	90,963	90,950
Office and miscellaneous	46,751	32,462
Regulatory expenses	29,624	23,201
Rent	96,197	93,610
Telecommunications	5,639	6,200
Travel and related costs	80,352	30,730
Wages and benefits [Notes 10 and 19]	<u>485,896</u>	<u>229,823</u>
	<u>976,176</u>	<u>633,547</u>
<b>Loss before other items</b>	<u>(3,247,188)</u>	<u>(2,353,080)</u>
<b>OTHER ITEMS</b>		
Write-down of patent rights and applications	-	<u>(29,800)</u>
Foreign exchange gain (loss)	3,614	<u>(11,744)</u>
Interest income	<u>42,423</u>	<u>15,757</u>
	<u>46,037</u>	<u>(25,787)</u>
<b>Loss for the year</b>	(3,201,151)	<u>(2,378,867)</u>
<b>Deficit, beginning of year</b>	<u>(5,048,078)</u>	<u>(2,669,211)</u>
<b>Deficit, end of year</b>	(8,249,229) \$	\$ (5,048,078)
<b>Basic and diluted loss per common share</b>	\$ (0.05)	\$ (0.08)
<b>Weighted average number of common shares outstanding</b>	62,135,213	28,780,325

The accompanying notes are an integral part of these financial statements.

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**STATEMENTS OF CASH FLOWS**  
(Expressed in Canadian Dollar)  
YEARS ENDED MAY 31

	2007	2006
<b>CASH FROM (USED IN) OPERATING ACTIVITIES</b>		
Loss for the year	\$ (3,201,151)	\$ (2,378,867)
Items not involving cash:		
Amortization of property and equipment	11,613	30,376
Amortization of patent rights and applications	37,752	29,482
Stock-based compensation	463,546	267,845
Write-down of patent rights and applications	-	29,800
Changes in non-cash working capital items:		
Increase in goods and services tax receivable	(117,285)	(25,525)
Decrease in research and development tax credit receivable	97,778	-
Increase in prepaid expenses	(3,440)	(14,419)
Increase in accounts payable and accrued liabilities	<u>148,671</u>	<u>128,222</u>
Cash used in operating activities	<u>(2,562,516)</u>	<u>(1,932,726)</u>
<b>CASH FROM (USED IN) INVESTING ACTIVITIES</b>		
Patent rights and applications	(48,152)	(47,710)
Purchase of property and equipment	(8,424)	(13,016)
(Increase) Decrease in short-term investments	<u>(133,077)</u>	<u>875,141</u>
Cash provided by (used in) investing activities	<u>(189,653)</u>	<u>814,415</u>
<b>CASH FROM (USED IN) FINANCING ACTIVITIES</b>		
Decrease in deposits	-	(736)
Increase in capital, net of issuance costs	2,569,829	-
Share subscriptions received in advance (net of issuance cost of \$1,875)	<u>998,125</u>	<u>-</u>
Cash provided by (used in) financing activities	<u>3,567,954</u>	<u>(736)</u>
<b>Net increase (decrease) in cash during the year</b>	<b>815,785</b>	<b>(1,119,047)</b>
<b>Cash, beginning of year</b>	<u><b>265,593</b></u>	<u><b>1,384,640</b></u>
<b>Cash, end of year</b>	<u><b>\$ 1,081,378</b></u>	<u><b>\$ 265,593</b></u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the year for interest	\$ -	\$ -
Cash paid during the year for income taxes	-	-

The accompanying notes are an integral part of these financial statements.

**1. BASIS OF PRESENTATION**

These financial statements of Welichem Biotech Inc. (the “Company” or “Welichem”) have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis which assumes that the Company will realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The Company has incurred significant losses to date, and as at May 31, 2007, the Company has an accumulated deficit of \$8,249,229 resulting from losses in the current and prior years. As the Company is in the early stages of the research and development of its products, the Company’s ability to continue operations is uncertain and is dependent on its ability to obtain sufficient financing and complete development and commercialization of its products and generate profit in the future. Management is planning to raise additional funds to finance expected growth. The outcome of these matters cannot be predicted at this time

These financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations in the normal course of business. Such adjustments could be material.

**2. NATURE OF OPERATIONS**

The Company is a biopharmaceutical company focused on the research and development and commercialization of new therapeutics for autoimmune / inflammatory diseases and cancer.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles which are presented in Canadian dollars. A summary of the significant accounting policies is as follows:

**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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**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. Patent rights and applications are amortized on a straight-line basis over the maximum period of ten years from the time of acquisition.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**Property and equipment**

Property and equipment are recorded at cost less accumulated amortization and are amortized over their expected useful lives on the following basis:

Lab equipment	30% declining balance
Office equipment	30% declining balance
Leasehold improvements	Term of the lease

The Company uses the half year rule in the year of acquisition.

**Impairment of long-lived assets**

The Company reviews the carrying value of its intangible assets with a finite life and equipment for existence of facts or changes in circumstances that might indicate a condition of impairment. An impairment loss would be recognized when the estimated undiscounted future projected cash flows expected to result from the use of the asset and its eventual disposition is less than the carrying amount. The amount of the impairment loss to be recorded is calculated by the excess of the carrying value over its fair value, with fair value being determined using a discounted cashflow analysis.

**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.

**Foreign Currency Translation**

The Company maintains its accounting records in Canadian dollars.

At the transaction date, transactions completed in foreign currencies are translated into Canadian dollars by the use of the exchange rate in effect at that date. Revenues and expenses are translated at the average exchange rate for the year. At the year end, monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end exchange rates. Non-monetary assets and liabilities are translated using historical exchange rates. Exchange gains and losses on translation are included in operations.

**Research and development expenses**

Research costs are expensed as incurred. 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, 2007 and 2006, the Company had not deferred any development costs.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**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 when there is reasonable assurance that the Company has complied with all conditions necessary to receive the grants and collectibility is reasonably assured.

**Research and development tax credits**

Research and development 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.

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

**Earnings (loss) per share**

Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share is calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury method. The treasury method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate. Diluted loss per share is equal to the basic loss per share as inclusion of common share equivalents securities are anti-dilutives in the years ended May 31, 2007 and 2006.

**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.

**4. CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS**

**[a] Cash equivalents**

Cash equivalents includes \$7,194 (US\$6,754) [2006 - \$171,373 (US\$154,386)] that are denominated in US dollars.

**[b] Short-term investments**

Short-term investments comprises \$133,077 [2006 - \$nil] of investment grade commercial paper with a weighted average interest rate of 4.829%. At May 31, 2007, the fair value of the investments approximated the carrying value.

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollar)  
MAY 31, 2007 and 2006

**5. PROPERTY AND EQUIPMENT**

	2007			2006		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Lab equipment	\$ 67,413	\$ 57,887	\$ 9,526	\$ 65,608	\$ 54,191	\$ 11,417
Office equipment	52,465	32,376	20,089	45,846	25,186	20,660
Leasehold improvements	44,891	44,891	0	44,891	44,164	727
	\$ 164,769	\$ 135,154	\$ 29,615	\$ 156,345	\$ 123,541	\$ 32,804

**6. PATENT RIGHTS AND APPLICATIONS**

	2007	2006
Patent rights and applications	\$ 401,964	\$ 353,811
Less: accumulated amortization	(112,024)	(74,272)
	\$ 289,940	\$ 279,539

Effective March 1, 2006, the Company changed its estimate of the remaining useful life of the patent rights and applications from 20 years to 10 years. The impact of this change in estimate was to increase amortization by approximately \$79,020 for the year ended May 31, 2006.

During the year ended May 31, 2006, the Company performed reviews of the carrying value of its patent rights and applications and, as a result, \$29,800 of net book value was written off with respect to technology not related to the Company's current focus. However, the Company has not written off any book value of the patent rights and applications for the year ended May 31, 2007 after similar review was performed.

**7. DEPOSIT**

Deposit consists of a term deposit of \$14,615 (2006 - \$14,615) held as collateral for the Company's credit card.

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollar)  
MAY 31, 2007 and 2006

**8. SHARE CAPITAL**

	Number of Shares	Amount
<b>Authorized</b>		
Unlimited number of common shares without par value		
<b>Common shares issued and outstanding:</b>		
Balance as at May 31, 2006 and 2005	28,780,325	\$ 5,238,644
Common shares issued in the private placement closed in July 2006, net of share issuance costs and fair value of detached warrants	37,536,000	1,806,586
Common Share issued in the exercise of options (b)	<u>105,000</u>	<u>15,898</u>
Balance as at May 31, 2007	66,421,325	\$ 7,061,128

- a) The Company issued 37,536,000 units comprising common shares at a price of \$0.075 per share and 18,768,000 warrants exercisable at \$0.20 up to July 12, 2008 in gross proceeds of \$2,815,200 less issuing costs of \$255,870 in a private placement in July 2006. [Note 11]
- b) 80,000 stock options were exercised at \$0.10 on January 18, 2007, and 25,000 stock options were exercised at \$0.10 on March 1, 2007.
- c) According to the escrow agreements signed in May 2005, a total of 11,045,102 shares were to be released over a 3-year period. As at May 31, 2007, a total of 3,313,537 shares are still in escrow.

**9. CONTRIBUTED SURPLUS**

	Amount
Balance, May 31, 2005	\$ 11,243
Stock-based compensation expense [Note 10]	<u>267,845</u>
Balance, May 31, 2006	\$ 279,088
Stock-based compensation expense [Note 10]	463,546
Warrants issued in private placement in July 2006 [Note 11]	752,744
Exercise of options	<u>(5,398)</u>
Balance, May 31, 2007	\$1,489,980

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollar)  
MAY 31, 2007 and 2006

**10. STOCK OPTIONS**

In the year ended May 31, 2007, the Company granted a total of 3,165,000 stock options (2006 – 2,850,000) to officers, directors, employees, and consultants. The options are exercisable anytime at a price of \$0.10 to \$0.15 per share (2006 - \$0.10 to \$0.34 per share) for a period of five years from date of grant. At the Company's AGM in October 2006, the shareholders approved an amendment to the stock option plan ("Incentive Stock Option Plan") whereby the number of shares reserved for granting pursuant to the exercise of options, which was previously fixed, is now equal to 10% of the number of shares and outstanding shares of the Company at any given time on a rolling basis. In addition, the shareholders approved the removal of vesting provisions including those related to stock options granted in prior years.

At May 31, 2007, stock options were outstanding enabling the holders to acquire the following number of common shares:

Number of Shares	Exercise Price	Expiry Date
200,000	\$ 0.10	January 31, 2011
1,795,000	0.10	May 7, 2011
1,990,000	0.10	August 31, 2011
1,055,000	0.135	January 31, 2012
150,000	0.15	July 30, 2011
240,000	0.20	July 31, 2008
150,000	0.20	January 30, 2012
188,100	0.22	December 31, 2009
300,000	0.22	March 15, 2010
241,500	0.22	May 25, 2010
50,000	0.23	May 25, 2010
<u>50,000</u>	0.23	June 1, 2010
<b>6,409,600</b>		

As at May 31, 2007, the weighted average remaining contractual life of the outstanding stock options is 3.9 years, and all the options are currently exercisable at an average price of \$0.13.

The following table summarizes the stock option activity under this Plan:

	Number of Options	Weighted Average Exercise Price
Balance, May 31, 2005	1,906,080	0.22
Options granted	2,850,000	0.12
Options cancelled	<u>(1,236,480)</u>	0.22
Balance, May 31, 2006	3,519,600	0.14
Options granted	3,165,000	0.11
Options cancelled	(170,000)	0.11
Options exercised	<u>(105,000)</u>	0.10
Options outstanding and exercisable on May 31, 2007	6,409,600	\$ 0.13

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollar)  
MAY 31, 2007 and 2006

**10. STOCK OPTIONS (cont'd.)**

**Stock-based compensation**

The Company recorded stock-based compensation costs of \$463,546 (2006 – \$267,845), including \$226,700 (2006 - \$nil) relating to the vesting acceleration of certain options, by applying the fair value method of accounting for stock options granted during the year ended May 31, 2007. The offsetting amount was recorded as contributed surplus on the balance sheet. [Note 9] This expense has been allocated to research and development expenses \$193,821 (2006 - \$145,313) and wages and benefits \$269,725 (2006 - \$122,532) on the same basis as cash compensation.

The fair value of all options granted has been estimated using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

	<u>2007</u>	<u>2006</u>
Risk-free interest rate	4.1%	3.2% to 4.3%
Expected life of options	3.2 to 5 years	3.2 years to 6 years
Annualized volatility	107%	207%
Dividend rate	Nil	Nil
Fair value per share	\$0.13	\$0.09

Option pricing models require the use of highly subjective estimates and assumptions including the expected stock price volatility. Changes in the underlying assumptions can materially affect the fair value estimates and, therefore, in management's opinion existing models do not necessarily provide reliable measure of the fair value of the Company's stock options.

**11. WARRANTS**

As at May 31, 2007, 18,768,000 warrants are outstanding. Each warrant entitles the holder to buy one common share at \$0.20 until July 11, 2008.

Warrants outstanding as at May 31, 2006 and 2005	6,818,183
Warrants issued in connection with the private placement	18,768,000
Warrants expired	<u>(6,818,183)</u>
Warrants outstanding as at May 31, 2007	<b><u>18,768,000</u></b>

The net proceeds (\$2,559,330) of the private placement were allocated between the common shares (\$1,806,586) and the warrants (\$752,744). The allocation was calculated by valuing the common shares and the warrants separately and adjusting the resulting amounts on a pro-rata basis so that the sum of the components is equal to the amount of cash received. The fair value of the common shares was assumed to be equal to the market share price multiplied by the number of common shares issued (37,536,000) in this private placement. The estimated fair value of warrants at \$752,744 was recorded as contributed surplus on the balance sheet [note 9].

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
 (Expressed in Canadian Dollar)  
 MAY 31, 2007 and 2006

**11. WARRANTS (cont'd.)**

The assumptions used in the calculation of the fair value of the warrants (using the Black-Scholes Option Pricing Model) were:

Risk-free interest rate	4.23%
Expected life of warrants	2 years
Annualized volatility	185%
Dividend rate	\$Nil

**12. RESEARCH AND DEVELOPMENT EXPENSES**

	2007	2006
Subcontractors, supplies and materials	\$ 1,858,069	\$ 1,304,790
Wages and benefits [Note 10]	<u>570,539</u>	<u>465,561</u>
	<u>\$ 2,428,608</u>	<u>\$ 1,770,351</u>
Less:		
Government assistance and other [Note 13]	<u>\$ (157,596)</u>	<u>\$ (50,818)</u>
	<u><b>\$ 2,271,012</b></u>	<u><b>\$ 1,719,533</b></u>

**13. GOVERNMENT ASSISTANCE**

Under an agreement through the Industrial Research Assistance Program ("IRAP"), the National Research Council of Canada ("NRC") agreed to reimburse certain of the Company's allowable direct expenditures on the evaluation of anti-cancer agents on a cost matching basis. During the year, the Company was awarded a financial contribution of up to \$350,000 over a two-year period by NRC – IRAP for research and development of its novel anti-cancer compound, WBI 2100. The Company received a grant totalling \$100,000 [2006 - \$nil] in this fiscal year.

During the year the Company also received grants from the Natural Sciences and Engineering Research Council of Canada ("NSERC") totalling \$57,000 (2006 - \$38,000) for fellowship payments for a post-doctoral researcher and employment of students by the Company.

During the year the Company also received grants from the Western Economic Division of Canada ("WED") totalling \$3,182 (2006 - \$12,818) for under the First Job – Science and Technology program for a research assistant employed by the Company.

**WELICHEM BIOTECH INC.**  
**(a development stage company)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollar)  
MAY 31, 2007 and 2006

**14. FINANCIAL INSTRUMENTS**

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying value of cash, short term investments, accounts receivable, Goods & Services tax receivable, and accounts payable 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.

**15. INCOME TAXES**

The reconciliation of income taxes attributed to operations computed at the statutory rate to income tax expense (recovery) using a 34.12% (2006 – 34.25%) statutory tax rate at May 31 is as follows:

	2007	2006
Loss before income taxes	\$ (3,201,151)	\$ (2,378,867)
Income taxes (recovery) at statutory rates	\$ (1,092,233)	\$ (814,762)
Expenses not deductible for tax purposes	188,226	91,900
Losses for which no benefit has been recognized	189,128	292,062
Other changes in valuation allowance	483,597	430,800
Income tax rate changes	<u>231,282</u>	<u>-</u>
	\$ -	\$ -

The significant components of the Company's future income tax assets as of May 31 are as follows:

	2007	2006
Future income tax assets		
Non-capital loss carry forwards	\$ 907,000	\$ 750,000
Capital loss carry forwards	7,000	15,000
Book amortization in excess of tax capital cost allowance	56,000	64,000
Share issue costs	87,000	38,000
Research and development deductions and credits	<u>1,241,000</u>	<u>1,199,000</u>
Total future tax assets	\$ 2,298,000	\$ 2,066,000
Less: valuation allowance	<u>(2,298,000)</u>	<u>(2,066,000)</u>
Net future income tax assets	\$ -	\$ -

# WELICHEM BIOTECH INC.

(a development stage company)

## NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Canadian Dollar)

MAY 31, 2007 and 2006

### 15. INCOME TAXES (cont'd.)

The potential income tax benefits relating to these future tax assets have not been recognized in these financial statements as there is no assurance that such amount are more likely than not to be realized under the liability method of tax accounting. Accordingly, a valuation allowance has been recorded and no future tax assets have been recognized as at May 31, 2007 and 2006.

As at May 31, 2007, the Company has non-capital losses of approximately \$2,927,000 (\$199,000 expiring in 2008, \$332,000 expiring in 2009, and \$2,396,000 expiring between 2010 and 2027), federal investment tax credits of approximately \$743,000 (expiring from 2011 to 2027) and provincial tax credits of approximately \$443,000 (expiring from 2015 to 2027) available to reduce taxable income and taxes payable in future years.

### 16. SEGMENTED INFORMATION

The Company primarily operates in one reportable operating segment, being the research and development of pharmaceutical products, in Canada.

### 17. COMMITMENTS

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

2007/08	\$ 64,460
2008/09	70,228
2009/10	73,848
2010/11	<u>24,616</u>
	<u>\$ 233,152</u>

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 \$420,744 to the CROs in the fiscal year 2007-08 when all the work is completed.

### 18. SUBSEQUENT EVENTS

In June 2007, the Company closed a non-broker private placement of 6,666,667 shares at a purchase price of \$0.15 per share, for a total of up to \$1,000,000 which was received prior to May 31, 2007. A finder's fee of \$66,842 was paid in connection with this private placement.

### 19. RELATED PARTY TRANSACTIONS

The Company paid \$267,118 (2006 - \$269,734) in wages, \$nil (2006 - \$3,750) for consulting services, and \$18,003 (2006 - \$17,490) in directors' fees to its former and current directors during the year.

As at May 31, 2007, the Company has a non-interest bearing payable of \$25,000 (2006 - \$nil) owed to a director of the Company.



## **WELICHEM BIOTECH INC.**

**(a development stage company)**

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Canadian Dollar)

MAY 31, 2007 and 2006

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### **20. TECHNOLOGY TRANSFER AGREEMENTS**

In September 2004, the Company entered into a Technology Transfer Agreement (the “Agreement”) with Celestial Pharmaceuticals (Shenzen) Ltd. (“CPL”), a company located in the People’s Republic of China (the “PRC”). Pursuant to the Agreement, the Company transferred and assigned its rights to certain of its proprietary technologies (“Transferred Technologies”) to CPL on a royalty-free basis to use, develop, improve and upgrade the Transferred Technologies, and to distribute, market and sell products derived or manufactured from the Transferred Technologies in the PRC, Hong Kong, Macao and Taiwan. CPL also subscribed 4,545,455 common shares of the Company for \$1,500,000.

In December 2005, Welichem licensed and assigned to CPL all its rights to develop, improve, upgrade, manufacture, distribute, and market, in and limited to Australia and Asia, of Welichem proprietary technology known as Novel Macrolide compounds with Antibiotic and Anti-neoplastic properties, in exchange for rights and licence granted to the Company with no additional cost for royalty-free use, development, improvement, upgrading, marketing and distribution worldwide of CPL’s proprietary cream formulation known as CPL-1000. In return, the Company has access to Celestial’s research data on any drug compounds related to the Company’s patents.

**Form 52-109F1 Certification of Annual Filings**

I, York Yingping Guo, Chief Executive Officer of *Welichem Biotech Inc.*, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of *Welichem Biotech Inc.*, (the issuer) for the period ending **May 31, 2007**;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings;
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
  - (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;
  - (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
  - (c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD & A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and
5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: September 26, 2007

“York Yingping Guo”  
York Yingping Guo  
President & Chief Executive Officer

**Form 52-109F1 Certification of Annual Filings**

I, **Samson Mui**, Chief Financial Officer of **Welichem Biotech Inc.**, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of **Welichem Biotech Inc.**, (the issuer) for the period ending **May 31, 2007**;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings;
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
  - (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;
  - (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
  - (c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD & A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and
5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: September 26, 2007

                  "Samson Mui"                    
Samson Mui  
Chief Financial Officer

# Corporate Directory

## Board of Directors

**Hugh Wynne-Edwards, O.C., Ph.D., D.Sc., FRSC.** *Chairman of the Board*

**Genhui Chen, Ph.D.**

**John Dustan, MBA**

**York Yingping Guo**

**John M. Webster, Ph.D., D.Sc .**

**Weihe Wang**

**Yeyan Zhang, Ph.D.**

**Feng hai shi**

**Zhaofang Zhang**

## Officers

**Hugh Wynne-Edwards, O.C., Ph.D., D.Sc., FRSC.** *Chairman of the Board and Director*

**York Yingping Guo, President, Chief Executive Officer and Director**

**John M. Webster, Ph.D., D.Sc . Chief Scientific Officer and Director**

**Samson C.W. Mui, MBA, P.Eng., CMA.** *Chief Financial Officer*

### Corporate Office

Welichem Biotech Inc.  
316-4475 Wayburne Drive  
Burnaby, British Columbia  
Canada V5G 3L1  
Tel.: 604-432-1703  
Fax: 604-432-1704  
Email: info@welichem.com  
Web: www.welichem.com

### Registered and Records Office

Clark Wilson LLP  
1500-1055 W. Georgia Street  
Vancouver, BC V6E 4N7

### Auditors

Ernst & Young LLP  
Chartered Accountants  
Pacific Centre - P.O. Box 10101  
700 W. Georgia Street  
Vancouver, BC V7Y 1C7  
Tel.: 604-891-8200  
Fax: 604-643-5422

### Share Registrar and Transfer Agents

Pacific Corporate Trust  
510 Burrard Street – 2<sup>nd</sup> Floor  
Vancouver, BC V6C 3B9  
Tel.: 604-689-9853  
Fax: 604-689-8144  
Email: pacific@pctc.com  
Web: www.pctc.com

### Annual General Meeting

Monday, October 29, 2007  
1:30 p.m. Pacific Standard Time  
The Diamond Alumni Centre, Rooms 2065  
Simon Fraser University at Harbour Centre  
515 W. Hastings Street  
Vancouver, BC V6B 5K3  
Canada

### Stock Listing

The Company's common shares are traded in Canada on the TSX Venture Exchange under the stock symbol WBI.

### Investor Contact

Dr. Yan Chen  
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Fax: 604-432-1704  
Email: yanchen@welichem.com