

**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>
<b>Total Assets</b>	<u>\$ 1,763,595</u>	<u>\$ 759,574</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<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>
<b>Total Liabilities and Shareholder's Equity</b>	<u>\$ 1,763,595</u>	<u>\$ 759,574</u>

**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>	<u>(3,201,151)</u>	<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>	<u>(8,249,229)</u>	<u>\$ (5,048,078)</u>
<b>Basic and diluted loss per common share</b>	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>
<b>Weighted average number of common shares outstanding</b>	<u>62,135,213</u>	<u>28,780,325</u>

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.

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

---

**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	<u>44,891</u>	<u>44,891</u>	<u>0</u>	<u>44,891</u>	<u>44,164</u>	<u>727</u>
	\$ 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	<u>(112,024)</u>	<u>(74,272)</u>
	\$ 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>
<b>Balance as at May 31, 2007</b>	<b>66,421,325</b>	<b>\$ 7,061,128</b>

- 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>
<b>Balance, May 31, 2007</b>	<b>\$1,489,980</b>

**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	<u><b>18,768,000</b></u>

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>\$ 2,271,012</u>	<u>\$ 1,719,533</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**

---

**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.