

AUDITORS' REPORT

To the Shareholders of
Welichem Biotech Inc.

We have audited the balance sheets of **Welichem Biotech Inc.** [a development stage enterprise] [the "Company"] as at May 31, 2010 and 2009 and the statements of operations and comprehensive loss 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 about 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, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Vancouver, Canada,
July 31, 2010.

Chartered Accountants

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

FINANCIAL STATEMENTS

MAY 31, 2010 and 2009

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

BALANCE SHEETS (See Note 1 – BASIS OF PRESENTATION AND GOING CONCERN)

(Expressed in Canadian Dollars)

AS OF MAY 31

	2010	2009
ASSETS		
Current		
Cash	\$ 79,499	\$ 141,559
Short-term investments	524,068	619,335
Government grant receivables	-	46,434
Goods and services tax receivables	41,709	5,078
Prepaid expenses	<u>42,350</u>	<u>33,499</u>
	687,626	845,905
Property and equipment [Note 8]	14,749	19,985
Deposit [Note 9]	<u>15,819</u>	<u>15,819</u>
Total Assets	\$ 718,194	\$ 881,709
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 268,622	\$ 512,697
Shareholders' equity		
Share capital [Note 10]	13,110,100	11,209,286
Contributed surplus [Note 11]	4,410,516	2,904,605
Deficit	<u>(17,071,044)</u>	<u>(13,744,879)</u>
	<u>449,572</u>	<u>369,012</u>
Total Liabilities and Shareholders' Equity	\$ 718,194	\$ 881,709

Nature of operations [Note 2]**Commitments** [Note 18]**On behalf of the Board:**

_____ Director _____ Director

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

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

	2010	2009
RESEARCH AND DEVELOPMENT EXPENSES [Notes 12, 14 & 15]	<u>\$ 2,758,042</u>	<u>\$ 2,068,700</u>
GENERAL AND ADMINISTRATIVE EXPENSES		
Amortization of property and equipment	5,236	7,188
Consulting	33,695	2,710
Directors' fees	2,250	16,650
Insurance	58,487	40,030
Investor relations	1,761	3,168
Legal and accounting fees	104,681	85,730
Loan interest	-	4,233
Office and miscellaneous	24,385	26,205
Public relations expenses	13,102	37,905
Regulatory expenses	40,355	50,687
Rent	84,056	106,815
Telecommunications	7,268	7,554
Travel and related costs	34,989	78,068
Wages and benefits [Note 12]	<u>162,843</u>	<u>245,291</u>
	<u>573,108</u>	<u>712,234</u>
Loss before other items	<u>(3,331,150)</u>	<u>(2,780,934)</u>
OTHER ITEMS		
Foreign exchange loss	(13,490)	(7,515)
Net loss on short-term investments - realized	(8,172)	-
Net gain on short-term investments - unrealized [Note 21]	24,068	78,221
Interest income	<u>2,579</u>	<u>8,274</u>
	<u>4,985</u>	<u>78,980</u>
Loss and comprehensive loss for the year	<u>(3,326,165)</u>	<u>(2,701,954)</u>
Deficit, beginning of year, as restated	<u>(13,744,879)</u>	<u>(11,042,925)</u>
Deficit, end of year	<u>(17,071,044)</u>	<u>(13,744,879)</u>
Basic and diluted loss per common share [Note 10]	<u>\$ (0.10)</u>	<u>\$ (0.16)</u>
Weighted average number of common shares outstanding [Note 10]	35,076,025	16,815,751

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 Dollars)
YEARS ENDED MAY 31

	2010	2009
CASH USED IN OPERATING ACTIVITIES		
Loss for the year	\$ (3,326,165)	\$ (2,701,954)
Add back (deduct):		
Government grants	(93,333)	(118,400)
Amortization of property and equipment	5,236	7,188
Stock-based compensation [Note 12(b)]	31,725	78,675
Unrealized (gains) on short-term investments	(24,068)	(78,221)
Realized loss on short-term investments	8,172	-
Changes in non-cash working capital items:		
(Increase) decrease in goods and services tax receivable	(36,631)	65,268
Decrease (increase) in government grant receivables	46,434	(46,434)
Increase in prepaid expenses	(8,851)	(12,805)
Decrease in accounts payable and accrued liabilities	<u>(244,075)</u>	<u>(115,802)</u>
Cash used in operating activities	<u>(3,641,556)</u>	<u>(2,922,485)</u>
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Purchase of equipment	-	(1,279)
Increase in deposits	-	(1,204)
Purchase of short-term investments	(2,000,000)	(2,750,000)
Redemption of short-term investments	<u>2,111,163</u>	<u>2,208,885</u>
Cash provided by (used in) investing activities	<u>111,163</u>	<u>(543,598)</u>
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Repayment of shareholder loan	-	(998,000)
Proceeds from private placement, net of share issuance costs	3,375,000	(497,000)
Government assistance received	<u>93,333</u>	<u>118,400</u>
Cash provided by (used in) financing activities	<u>3,468,333</u>	<u>(1,376,600)</u>
Net decrease in cash	(62,060)	(4,842,682)
Cash, beginning of year	<u>141,559</u>	<u>4,984,241</u>
Cash, end of year	\$ 79,499	\$141,559
Supplemental disclosure of cash flow information:		
Cash received (paid) for interest	\$ 8,587	\$ (27,521)
Cash paid for income taxes	-	-

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

1. BASIS OF PRESENTATION AND GOING CONCERN

These financial statements of Welichem Biotech Inc. (the “Company” or “Welichem”) have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) on a going concern basis, which presumes that the company will be able to 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, 2010, the Company has accumulated a deficit of \$17,071,044 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 as a going concern is uncertain, and is dependent on its ability to obtain sufficient financing to complete development and commercialization of its products and to generate profit in the future. There can be no assurance that the Company will be able to obtain sufficient financing to meet future operational needs after twelve months. As a result, there is a significant doubt as to whether the Company will be able to continue as a going concern and realize its assets and pay its liabilities as they fall due.

These financial statements do not include any adjustments to the amounts and classifications of assets and liabilities which 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 drug discovery and early stage drug development company focusing on new therapeutics for autoimmune / inflammatory diseases and cancers. All the company’s drug candidates are derived from the metabolites of bacterial symbionts of soil living nematodes. Currently, the Company is conducting phase II clinical studies on its lead drug candidate, WBI-1001, as a topical treatment for two inflammatory skin disorders: psoriasis and eczema.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by the Company in Canadian dollars and in accordance with Canadian GAAP, applied on a consistent basis. The significant accounting policies that the Company believes are the most critical in fully understanding and evaluating the reported financial results include the following:

Use of estimates

The preparation of these consolidated financial statements, in conformity with Canadian GAAP, requires the Company to make certain estimates and assumptions. Management believes that the estimates and assumptions upon which it relies are reasonable based on information available at the time that these estimates and assumptions are made. Areas of significant estimates include: amortization of equipment and stock-based compensation. Actual results could differ from these estimates.

Cash

Cash consists of unrestricted cash on hand and held in bank accounts.

3. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Short-term investments

The Company considers fixed income investments, marketable securities and other highly liquid financial instruments purchased with a maturity greater than 90 days but less than one year at the date of purchase as short term investments. Short-term investments are classified as held-for-trading and are recorded at fair value using quoted market prices at the balance sheet date. Gains or losses on held-for-trading investments are recognized in earnings. Investment transactions are recognized on the trade date with transaction costs included in earnings.

Accounts payable and accrued liabilities

Accounts payable and accrued liabilities are typically short-term in nature and classified as other financial liabilities. These liabilities are carried at amortized cost.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

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 stock options granted to employees and directors is recognized as compensation expense and charged to general and administrative expenses and research and development expenses on a straight line basis over the vesting period with a corresponding credit to contributed surplus. The fair value of stock-based awards to non-employee consultants is measured at the earliest of the performance commitment date, the service delivery date, or the grant date if they are fully vested and non-forfeitable. The fair value of direct awards of stocks is determined by the quoted market price of the Company's stock.

Foreign currency transaction

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 GAAP 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 of May 31, 2010 and 2009, the Company has 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 when there is reasonable assurance that the Company has complied with all conditions necessary to receive the grants and collectability is reasonably assured.

3. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

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 is anti-dilutive in the years ended May 31, 2010 and 2009.

Financial instruments

Section 3855 establishes standards for recognizing financial assets, financial liabilities and non-financial derivatives. It requires the financial assets, financial liabilities, including derivatives, be recognized on the balance sheet when the Company becomes a party to the contractual provisions of financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Cash and short-term investments are classified as held-for-trading. Government grant receivables and goods and services receivables are classified as loans and receivables. Accounts payable and accrued liabilities are classified as other financial liabilities. Financial assets and financial liabilities held for trading are measured at fair value with changes in fair value recognized in other income. Loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method. Transaction costs are expensed as incurred.

Income taxes

Income taxes are accounted for 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 is 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. ADOPTION OF NEW ACCOUNTING POLICIES

During the year ended May 31, 2010, the Company adopted the CICA issued sections as following:

Section 3862, Financial Instruments – Disclosure

In June 2009, the CICA amended Section 3862 which places heightened importance on disclosures, and enables financial statement users to assess the nature and extent of the risks associated with the financial instruments to which the Company is exposed and the manner in which it manages these risks. Section 3862 now requires that all financial instruments measured at fair value be categorized into one of the three hierarchy levels as follows:

- Level 1 – Unadjusted quoted prices in active markets for identical assets and liabilities;
- Level 2 – Inputs, other than quoted prices in active market, that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

The amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009. The amendments are effective for the Company's annual financial statements for the year ended May 31, 2010 and its adoption did not have an impact on the financial position, cash flow or results of operations of the Company. The required disclosures are provided in note 7.

Section 3855, Financial Instruments – Recognition and Measurement

In 2009, the CICA made several amendments and clarifications to Section 3855 to converge with international standards for impairment of debt instruments by changing the categories into which debt instruments are required or permitted to be classified. The adoption of these amendments did not have a material impact on the Company's financial statements.

Section EIC 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

In January 2009, the Emerging Issues Committee ("EIC") of the CICA issued EIC 173, which details guidance on the implications of credit risk in determine fair value of an entity's financial assets and financial liabilities. The guidance clarifies that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determine the fair value of financial assets and financial liabilities, including derivative instruments, for presentation and disclosure purpose. EIC 173 was effective from the date of issuance and did not have a significant impact on the Company's financial statements.

5. NEW ACCOUNTING PRONOUNCEMENTS

Section 1582, Business Combinations

This Section establishes the standards for the accounting of business combinations, and stated that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at acquisition date fair value. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to the International Financial Reporting Standard on business combinations. The Company will be required to adopt this standard prospectively for business combinations with acquisition dates on or after April 1, 2011, but may adopt the standard sooner. The Company will assess the impact of adopting this standard on its financial statements.

Section 1601, Consolidated Financial Statements

This Section establishes the standards for preparing consolidated financial statements and is effective for the Company on April 1, 2011. The Company will assess the impact of adopting this standard on its financial statements.

Section 1602, Non-Controlling Interests

This Section establishes the standards for accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination, and effective for the Company on April 1, 2011. The Company will assess the impact of adopting this standard on its financial statements.

International Financial Reporting Standards

In March 2009, the Canadian Accounting Standards Board (the “AcSB”) reconfirmed that Canadian public companies must change over to International Financial Reporting Standards (“IFRS”) for accounting periods commencing on or after January 1, 2011. Accordingly, the Company’s first quarter under IFRS will be the three-month period ending August 31, 2011. The Company has completed the diagnostic phase which involved a high-level review of the differences between current Canadian GAAP and IFRS. Although the transition to IFRS will generate more disclosures, the Company believes that the information technology and internal control over financial reporting will not require significant changes based on its current research and development activities and the nature of the assets and liabilities of the Company. The Company is continuously assessing the implication of the transition and/or disclosure requirements

6. CAPITAL DISCLOSURES

The Company manages its capital with the purpose of safeguarding its accumulated capital in order to maintain its ability to continue as a going concern and to advance its research, development and commercialization activities. The capital structure of the Company consists of shareholder's equity.

The Company manages its capital structure and makes adjustments to it based on economic conditions and the risk characteristics of the underlying assets. The Company, upon approval from its board of directors, will balance its overall capital structure through new shares or debt issuances or by undertaking other activities as deemed appropriate under specific circumstances.

The Company expects that its current capital resources will support its research and development plans and operations into September 2010. The Company is seeking additional funding by issuing rights offering to its current shareholders or by private placements. The Company is not subject to any externally imposed capital requirements and the overall strategy with respect to capital management remains unchanged from the prior year.

7. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANEGEMENT

[a] Financial instruments

The Company has classified its financial instruments as following:

Financial Instrument	Classification	Subsequent Measurement	May 31, 2010	May 31, 2009
Cash	Held-for-trading	Fair value	\$ 79,499	\$ 141,559
Short-term investments	Held-for-trading	Fair value	524,068	619,335
Government grant and goods and service tax receivables	Loans and receivables	Amortized cost using the effective interest method	41,709	51,512
Accounts payables and accrued liabilities	Other financial liabilities	Amortized cost using the effective interest method	\$ 268,622	\$ 512,697

Cash and short-term investments are carried at fair value (Level 1 financial assets). The carrying amount of goods and services tax receivables, government grant receivables, accounts payables and accrued liabilities is a reasonable approximation of their fair values due to the short term nature of these instruments. As of May 31, 2010 and 2009, the Company did not have Level 2 and Level 3 financial assets and financial liabilities.

The Company did not have any held-to-maturity or available-for-sale financial instruments, nor did it acquire or hold any financial derivatives during the years ended May 31, 2010 and 2009.

WELICHEM BIOTECH INC.
(a development stage company)
NOTES TO THE FINANCIAL STATEMENTS
(Expressed in Canadian Dollars)
MAY 31, 2010 and 2009

7. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (CONT'D)

[b] Financial risk management

Credit Risk

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and short-term investments. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The Company invests its excess cash principally in highly rated Canadian government bonds and money market fund units to limit the credit risk.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due or to fund the programs and commitments that the Company has planned. The Company controls its liquidity risk through the management of its capital structure, cash flow and the availability and sourcing of financing. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities. The Board of Directors reviews and approves any material transactions of the Company. Contractual obligations as of May 31, 2010 are as follows:

	Within 1 Year	Less than 3 Years	Less than 5 Years	Total
Accounts payable and accrued liabilities	\$268,622	\$ -	\$ -	\$268,622

Foreign Currency Risk

Foreign currency risk is the risk that the fair value of future cash flow of a financial instrument will change because of fluctuation of foreign exchange rates.

The Company uses consulting contract research services with several United States based entities and payments to such suppliers are in United States dollars ("U.S. dollar"). As a result, the Company is subject to fluctuation in exchange rates which can give rise to foreign currency exposure, either favorable or unfavorable. The Company does not engage in any foreign currency hedging activities. As of May 31, 2010, the Company has financial instruments denominated in U.S. dollars and is exposed to currency risk as following:

US Dollar	May 31, 2010	May 31, 2009
Cash	\$ 21,858	\$ 58,233
Accounts payable and accrued liabilities	\$ -	\$ (390,166)
	\$ 21,858	\$ (331,933)

The Company has completed a sensitivity analysis to estimate the impact on net income for the period which a change in foreign exchange rate during the year ended May 31, 2010 would have had. The result of the sensitivity analysis shows that assuming all other variables remain constant, a 10% weakening or strengthening of the Canadian dollar against the US dollar would result in a decrease or increase of \$2,270 in the Company's net loss and comprehensive loss for the year ended May 31, 2010.

WELICHEM BIOTECH INC.
(a development stage company)
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(Expressed in Canadian Dollars)
MAY 31, 2010 and 2009

7. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANEGEMENT (CONT'D)

[b] Financial risk management (cont'd)

Interest Rate Risk

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary for daily operations. The Company invested its excess cash in highly liquid government bonds and exposed to the risk of interest rate changes. Given the level of cash held by the Company during the year ended May 31, 2010 and 2009, fluctuations in the market interest rates had no significant impact on its interest income.

8. PROPERTY AND EQUIPMENT

	May 31, 2010			May 31, 2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Lab equipment	\$ 67,948	\$ 63,958	\$ 3,990	\$ 67,948	\$ 62,542	\$ 5,406
Office equipment	<u>59,563</u>	<u>48,804</u>	<u>10,759</u>	<u>59,563</u>	<u>44,984</u>	<u>14,579</u>
	\$ 127,511	\$ 112,762	\$ 14,749	\$ 127,511	\$ 107,526	\$ 19,985

9. DEPOSIT

Deposit consists of a term deposit of \$15,819 (May 31, 2009 - \$15,819) held as collateral for the Company's credit card.

WELICHEM BIOTECH INC.
(a development stage company)
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(Expressed in Canadian Dollars)
MAY 31, 2010 and 2009

10. SHARE CAPITAL

The Company has authorized unlimited number of common shares without par value. Issued and outstanding common shares are as follows:

	Pre-consolidation Number of Shares	Post-consolidation Number of Shares	Amount
Balance as at May 31, 2008	73,362,992	7,336,299	\$ 8,066,286
Common shares issued in the private placement closed in June 2008, net of share issuance costs (a)	<u>100,000,000</u>	<u>10,000,000</u>	<u>3,143,000</u>
Balance as at May 31, 2009 (b)	173,362,992	17,336,299	\$ 11,209,286
Common shares issued in the private placement closed in September 2009, net of share issuance costs (c)	-	25,000,000	3,375,000
Warrants issued in the private placement (c) [Note 13]	<u>-</u>	<u>-</u>	<u>(1,474,186)</u>
Balance as at May 31, 2010	-	42,336,299	\$ 13,110,100

- a) The Company commenced a private placement in 2008 to issue 100,000,000 units comprising common shares (pre-consolidation) at a price of \$0.05 per share and 50,000,000 warrants (pre-consolidation) exercisable at \$0.10 up to June 20, 2010 in gross proceeds of \$5,000,000 less share issuance costs of \$497,000. The gross proceeds were received in 2008 and the private placement was completed and shares and warrants were issued in 2009.
- b) On September 3, 2009, the TSX Venture Exchange (the "TSX-V") approved the Company to consolidate all of the issued and outstanding common shares on the basis of one post-consolidation common share for every ten pre-consolidation common shares. Each option, warrant, or other securities of the Company convertible into pre-consolidation common shares that have not been exercised or cancelled prior to the implementation of the share consolidation are adjusted pursuant to the terms thereof on the basis of one post-consolidation common share for every ten pre-consolidation common shares (i.e. the number of common shares issuable decreases while the exercise price increases). The weighted average numbers of common share outstanding and loss per share are recalculated retroactively for all periods presented to reflect the change. The loss per share before consolidation of \$0.02 in 2009 was adjusted to \$0.16 in 2009 after consolidations.
- c) On September 15, 2009, the Company completed a private placement of 25,000,000 units at a price of \$0.15 per unit for gross proceeds of \$3,750,000 less share issuance costs of \$375,000. Each unit is comprised of one post-consolidation common share and one-half of one non-transferable share purchase warrant. Each non-transferable share purchase warrant is exercisable into one post-consolidation common share at a price of \$0.15 for a period of 24 months from the date of issuance of the warrant.

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11. CONTRIBUTED SURPLUS

	Amount
Balance , May 31, 2008	\$1,465,930
Warrants issued in private placement in June 2008 [Note 13]	1,360,000
Stock-based compensation expense [Note 12(b)]	<u>78,675</u>
Balance, May 31, 2009	\$2,904,605
Warrants issued in private placement closed in September 2009 [Note 13]	1,474,186
Stock-based compensation expense [Note 12(b)]	<u>31,725</u>
Balance, May 31, 2010	<u>\$ 4,410,516</u>

12. STOCK OPTIONS

[a] Stock options

The Company has a stock option plan which provides for the granting up to 10% of its outstanding common shares to acquire its common shares to its officers, directors, employees and consultants. The option generally has a five year term and may be exercised with graded vesting schedule of 25% on the grant date and 25% in every 6 month after. Vested but unexercised options expire and unvested options are forfeited on the ninetieth day after the date upon which the optionee ceases to be a director, officer, employee or consultant of the Company prior to the expiry Date.

On September 25, 2008, the Company granted 470,000 stock options (post-consolidation) at an exercise price of \$1.00 for a period of 5 years expiring on September 24, 2013 with graded vesting schedule of 25% on the grant date and 25% in every 6 month after to its officers, directors, employees, and consultants.

As of May 31, 2010, outstanding and vested (exercisable) stock options which enable holders to acquire the following number of common shares:

Number of Outstanding Options (Post-consolidation)	Number of Exercisable Options (Post-consolidation)	Exercise Price	Expiry Date
51,500	51,500	\$1.00	May 7, 2011
31,000	31,000	\$1.00	August 31, 2011
26,000	26,000	\$1.35	January 31, 2012
<u>120,000</u>	<u>120,000</u>	\$1.00	September 24, 2013
<u>228,500</u>	<u>228,500</u>		

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12. STOCK OPTIONS (CONT'D)

[a] Stock options (cont'd)

As of May 31, 2010, the weighted average remaining contractual life of the outstanding stock options is 2.32 years, and all the options are currently exercisable at an average price of \$1.04 (Post-consolidation).

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

	Post-consolidation Number of Options	Weighted Average Exercise Price
Balance, May 31, 2008	598,460	\$1.30
Options granted	470,000	\$1.00
Options cancelled	<u>(197,000)</u>	\$1.50
Balance, May 31, 2009	871,460	\$1.09
Options granted	-	-
Options forfeited	(89,500)	\$1.00
Options expired	<u>(553,460)</u>	\$1.15
Options outstanding on May 31, 2010	228,500	\$1.04
Options exercisable on May 31, 2010	228,500	\$1.04

[b] Stock-based compensation

The Company has recorded stock-based compensation expenses of \$31,725 for 2010 (2009 – \$78,675). The credit amount is recorded as contributed surplus on the balance sheet [Note 11]. This expense has been allocated to general wages and benefits \$14,975 (2009 - \$47,425), research and development wage expenses \$13,625 (2009 - \$25,375) and research and development consulting expenses \$3,125 (2009 - \$5,875) on the same base as cash compensation.

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

	<u>September 25, 2008</u>
Risk-free interest rate	3.12%
Expected life of options	5 years
Volatility	150%
Dividend yield	Nil
Weighted average fair value of each option	\$0.03

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.

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13. WARRANTS

As of May 31, 2010, 17,500,000 warrants are outstanding. 5,000,000 warrants entitle the holder to purchase one common share at a price of \$1.00 per warrant expiring on June 20, 2010 and 12,500,000 warrants entitle the holder to purchase one common share at a price of \$0.15 per warrant expiring for a period of 24 months from the date of issuance of the warrant.

	Post-consolidation
Warrants outstanding as at May 31, 2008	1,876,800
Warrants issued in connection with the private placement in June 2008	5,000,000
Warrants expired	(1,876,800)
Warrants outstanding as at May 31, 2009	5,000,000
Warrants issued in connection with the private placement in September 2009	12,500,000
Warrants outstanding as at May 31, 2010	17,500,000

On June 20, 2008, net proceeds (\$4,503,000) of the private placement were allocated between the common shares (\$3,143,000) and the warrants (\$1,360,000). 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 estimated fair value of warrants at \$1,360,000 was recorded as contributed surplus on the balance sheet [Note 11].

On September 15, 2009, net proceeds (\$3,375,000) of the private placement were allocated between the common shares (\$1,900,814) and the warrants (\$1,474,186). 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 estimated fair value of warrants at \$1,474,186 was recorded as contributed surplus on the balance sheet [Note 11].

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

	September , 2009	June 20, 2008
Risk-free interest rate	1.35%	3.524%
Expected life of warrants	2 years	2 years
Volatility	293%	208%
Dividend yield	\$Nil	\$Nil

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14. RESEARCH AND DEVELOPMENT EXPENSES

	2010	2009	Accumulative since 2005
Subcontractors, supplies and materials	\$ 2,356,462	\$ 1,647,209	\$ 9,216,851
Patent costs	104,143	112,217	545,922
Wages and benefits [Note 12(b)]	<u>344,336</u>	<u>474,108</u>	<u>2,630,298</u>
	<u>\$ 2,804,941</u>	<u>\$ 2,233,534</u>	<u>\$ 12,393,071</u>
Less:			
Government assistance and other subsidies [Note 15]	<u>\$ (46,899)</u>	<u>\$ (164,834)</u>	<u>\$ (696,013)</u>
	<u>\$ 2,758,042</u>	<u>\$ 2,068,700</u>	<u>\$ 11,697,058</u>

15. GOVERNMENT ASSISTANCE AND OTHER SUBSIDIES

Under an agreement through the Industrial Research Assistance Program ("IRAP"), the National Research Council of Canada ("NRC") agreed to reimburse the Company's certain allowable direct expenditures on the evaluation of anti-cancer agents on a cost matching basis. The Company was awarded a financial contribution of up to \$460,693 covering period from year 2006 to year 2009 by NRC – IRAP for research and development of its novel anti-cancer compound, WBI-2100. On April 1, 2009 the Company was granted another \$93,333 award for the fiscal year of 2009 to 2010. During the fiscal year ended May 31, 2010, the Company received grants of \$93,333 out of which \$46,434 was accrued in prior fiscal year.

16. INCOME TAXES

The reconciliation of income taxes attributed to operations computed at the statutory rate to income tax expense (recovery) using a 29.375% (2009 – 33.375%) statutory tax rate at May 31 is as follows:

	2010	2009
Loss before income taxes	\$ (3,326,165)	\$ (2,701,954)
Income taxes (recovery) at statutory rates	\$ (977,061)	\$ (820,719)
Expenses not deductible for tax purposes	8,123	24,783
Losses for which no benefit has been recognized	327,947	307,982
Other changes in valuation allowance –SRED & Other	494,818	245,816
Income tax rate changes	0	85,297
Rate differential for current year tax benefits	<u>146,173</u>	<u>156,841</u>
Total	<u>\$ -</u>	<u>\$ -</u>

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16. INCOME TAXES (CONT'D)

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

	2010	2009
Future income tax assets		
Non-capital loss carry forwards	\$ 1,615,000	\$ 1,298,000
Capital loss carry forwards	3,000	5,000
Book amortization in excess of tax capital cost allowance	147,000	145,000
Share issuance costs	169,000	136,000
Research and development deductions	2,125,000	1,718,000
Investment tax credits	<u>1,876,000</u>	<u>1,403,000</u>
Total future income tax assets	\$ 5,935,000	\$ 4,705,000
Less: valuation allowance	<u>(5,935,000)</u>	<u>(4,705,000)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>

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 amounts 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, 2010 and 2009.

As at May 31, 2010, the Company has non-capital losses of approximately \$6,458,000 (\$214,000 expiring in 2011, and \$6,244,000 expiring between 2014 and 2030), federal investment tax credits of approximately \$1,826,000 (expiring from 2021 to 2030) and provincial tax credits of approximately \$675,000 (expiring from 2015 to 2020) available to reduce taxable income and taxes payable in future years.

17. SEGMENTED INFORMATION

The Company primarily operates in one reportable operating segment, being the research and development of pharmaceutical products, with substantially all of its assets and operations located in Canada.

18. COMMITMENTS

The Company did not have any lease commitment at the end of May 31, 2010.

The Company entered into agreements and contracts with various contract research organizations (the "CROs") related to its different research and development projects and will be obliged to pay a total of \$1,023,030 to the CROs if all the work is completed.

19. RELATED PARTY TRANSACTIONS

All related party transactions are recorded at the exchange amounts established and agreed by the related parties. On November 30, 2007, the Company established a loan of \$1,000,000 with Canadian Maple Leaf Investment Ltd. (CMLI), a major shareholder of the Company at that time with annual interest rate of 2% calculated daily based on the daily closing balance and to be paid at maturity. On June 23, 2008, the Company fully repaid the principal plus interests of \$27,521. There was no related party transaction occurred in the fiscal year ended May 31, 2010.

20. TECHNOLOGY TRANSFER AGREEMENTS

In September 2004, the Company entered into a Technology Transfer Agreement (the "Agreement") with Celestial Pharmaceuticals (Shenzhen) 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 (the "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, Macau 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 of 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 license 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-1001. In addition, the Company has access to Celestial's research data on any drug compounds related to the Company's patents.

21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified from statements previously presented to conform to the presentation of current year financial statements.

22. SUBSEQUENT EVENTS

On June 15, 2010, the Company announced that it intended to conduct a rights offering (the "Rights Offering") which results in the Company issuing rights (the "Rights") to the shareholders of the Company to purchase up to 10,584,826 common shares (the "Common Shares") of the Company, where permitted by law.

The Rights Offering circular was filed with Canadian securities regulatory authorities in applicable qualified jurisdictions (the "Qualified Jurisdictions") and with the TSX-V on July 9, 2010. Each shareholder of the Company on the record date (July 23, 2010) was offered to receive one Right for each one Common Share held. Four rights plus the subscription price of \$0.075 was offered to subscribe for each Common Share under the Rights Offering.

On September 1, 2010, the Rights Offering was completed. Including the Common Shares issued pursuant to the stand-by guarantee, the Company has issued an aggregate of 10,055,584 Common Shares in connection with the Rights Offering, at \$0.075 per Common Share for aggregate gross proceeds of \$754,169. The Company has close to approximately 52.4 million Common Shares issued and outstanding after the completion of this Rights Offering.