



Afexa Life Sciences Inc.

FIRST QUARTER REPORT

Management's Discussion and Analysis
For the three months ended June 30, 2011



Management's Discussion and Analysis

For the period ended June 30, 2011

The following Management's Discussion and Analysis ("MD&A") for Afexa Life Sciences Inc. ("Afexa" or "the Company") was prepared as of August 18, 2011 to assist readers in understanding our consolidated financial performance for the three months ended June 30, 2011. This MD&A should be read in conjunction with the accompanying unaudited interim consolidated financial statements for the three months ended June 30, 2011 and the notes contained therein. In addition, this MD&A should be read in conjunction with the MD&A and audited consolidated financial statements for the year ended March 31, 2011.

International Financial Reporting Standards ("IFRS") has replaced Canadian generally accepted accounting principles ("Canadian GAAP") for publicly accountable enterprises for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting using IFRS as issued by the International Accounting Standards Board ("IASB") for our interim consolidated financial statements ended June 30, 2011 and the comparative period. Details of the more significant accounting differences can be found in the "Changes in Accounting Policies Including Transition to IFRS" section of this MD&A and in our unaudited interim consolidated financial statements ended June 30, 2011.

The policies applied are based on IFRS issued and outstanding as of August 18, 2011. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending March 31, 2012 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

This MD&A contains forward-looking statements. Please see the section "Advisory Regarding Forward-looking Statements" for a discussion of the risks, uncertainties and assumptions used to develop our forward-looking statements. This MD&A also refers to certain non-IFRS financial measures to assist users in assessing our performance. Non-IFRS financial measures do not have any standard meaning prescribed by IFRS and may not be comparable to similar measures presented by other issuers. These measures are identified and described under the section "Non-IFRS Financial Measures and Reconciliations".

These accounting principles require us to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. We believe these estimates and assumptions are reasonable based on the information available at the time that these estimates and assumptions are made. These estimates and assumptions have been discussed with the Audit Committee of the Board of Directors of Afexa. Actual results may differ under different assumptions and conditions.

Additional information on Afexa, including our most recently filed Annual Information Form dated June 24, 2011, MD&A and audited consolidated financial statements, are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

OUR BUSINESS

We are a life sciences and technology company founded in 1992 and headquartered in Edmonton, Alberta, Canada. We have developed, commercialized and patented a proprietary technology, known as ChemBioPrint, which is used in the discovery and biological standardization of natural products that deliver consistent, verifiable and provable health benefits. Using the ChemBioPrint® product discovery and standardization platform, our scientists are able to precisely identify the chemical profile and biological activity of natural products. The process involves a combination of chemical and biological fingerprinting to ensure that the creation and scientific substantiation of our natural health products are safe, effective and consistent. We are committed to using a pharmaceutical model (involving rigorous drug discovery and clinical development methods) to develop natural medicines for health maintenance and disease prevention. Our efforts in scientific research and product innovation are key factors in enabling us to secure the trust of consumers, trade professionals, healthcare practitioners and government.

Our lead commercial product, COLD-FX®, is approved to help reduce the frequency, duration, and severity of cold and flu symptoms by strengthening the immune system. COLD-FX continues to be the number one selling cold and flu remedy in Canada (source: The Nielsen Company MarketTrack National all channel dollar sales for the categories of Cold Remedies and Supplements and Products (“Point of Sale Data”), 52 weeks ended July 2, 2011). We recently licensed and launched COLDSORE-FX® in Canada and have a product pipeline of polymolecular drugs at various clinical and pre-clinical development stages. This product pipeline includes COLD-FX pediatric, AFX-2 for Chronic Lymphocytic Leukemia (“CLL”), Dilexaponan for cholesterol management, HT-1001 for oxidative stress, and products for blood glucose and allergy management.

VISION AND STRATEGY

Our vision is to deliver the most trusted health brand on the planet. We plan to achieve our vision by pioneering the development of evidence-based natural medicines that empower people to achieve their health potential. Our integrated business model has three key components; the Canadian commercial business, COLD-FX and serial development.

The Canadian commercial business is a fully integrated commercial operation, with capacity to manage all aspects of product supply, marketing, sales and distribution. We have structured ourselves to effectively support our existing product portfolio, which also serves as a foundation to launch our organic and in-licensed product pipeline.

We believe the globalization of COLD-FX will be successful given the need for clinically proven and safe natural cold and flu products in markets beyond Canada (see “Advisory Regarding Forward-looking Statements”). Afexa previously announced the United States Federal Drug and Administration’s (“FDA”) approval of a Phase 1B clinical trial investigating COLD-FX’s active ingredient (AFX-2) as an investigational new drug candidate for the reduction in the incidence, duration and severity of acute respiratory illness among CLL patients. We are also pursuing regulatory approval for the sale of CVT-E002™ in China.

Serial development is driven by our research and development of botanical polymolecular formulations using our ChemBioPrint technology. We intend to continue to use the clinical development rigour expected of traditional over-the-counter (“OTC”) products in Canada (see “Advisory Regarding Forward-looking Statements”). Our development pathway allows us to develop innovative, highly differentiated, natural medicines with the potential to create new product categories rather than compete in crowded markets. Our research and development will focus on meeting the FDA clinical and regulatory requirement to accelerate access to the global markets (see “Advisory Regarding Forward-looking Statements”). This approach is intended to allow us to continue to expand the Canadian product portfolio.

Our products are derived from natural ingredients and we believe they will have a safety profile superior and more preferred by consumers than OTC small molecule chemical entities typically developed by pharmaceutical companies. Based on this, we anticipate our products will be less expensive to develop under the FDA pathway and require less time to complete. Strategic partnership agreements are being pursued at various stages of product development on a product-by-product basis to accelerate approval timelines where commercialization potential can be further optimized (see “Advisory Regarding Forward-looking Statements”).

Our strategic plan is designed to deliver to our shareholders average annual revenue growth in excess of 10% by the end of the next five years (see “Advisory Regarding Forward-looking Statements”). Our growth strategies are well underway to achieving this goal.

PRODUCT PIPELINE

Using our patented technology, ChemBioPrint, we have developed a number of product candidates derived from natural sources that have demonstrated therapeutic potential in the immunology, metabolic and neurological related areas. The following is a summary of therapeutic areas that have product candidates under development. The estimated completion of the regulatory milestones in the following table are based on a U.S. drug regulatory pathway (see “Advisory Regarding Forward-looking Statements”).

Target Indications with Products Under Development and Estimated Fiscal Year of Completion

	Initial Investigational New Drug ("IND") Submission*	New Drug Application ("NDA")*
CLL supportive therapy	Submitted	2017
Lipid management (high cholesterol)	2013	2020
Glucose management	2014	2021
Hypertension	2015	2022
Allergy	2016	2023

* Based on U.S. regulatory uncertainty (see "Advisory Regarding Forward-looking Statements").

KEY ACCOMPLISHMENTS THIS QUARTER

- We announced on July 18, 2011 that the FDA authorized a Phase 1B clinical trial of AFX-2 (CVT-E002), the active ingredient in COLD-FX) as an investigational new drug ("IND") in adults with CLL. This successful milestone marks the initiation of our strategy to obtain FDA approval of one of the first medicines in the oncology polymolecular botanical drug.
- An interim analysis performed by an independent data monitoring committee ("IDMC") for the currently in-progress COLD-FX clinical trial in a pediatric population revealed a favourable trend which supported the IDMC unanimous recommendation to continue the trial in the 2011/2012 cold and flu season.
- We expanded our Quebec direct broker sales model to Ontario to increase our ability to merchandise and educate health care professionals on our commercialized products.
- We commenced shipping to our Canadian retail customers our first in-licensed product, COLDSORE- FX. COLDSORE-FX has been granted a Natural Product Number ("NPN") from Health Canada's Natural Health Products Directorate, allowing the product to be sold in Canada as an OTC remedy clinically proven to speed the rate of healing while reducing pain associated with cold sores. We believe this product will be beneficial to the significant number of Canadians that suffer from recurring cold sores (see "Advisory Regarding Forward-looking Statements").
- We commenced our plans to enter the Chinese market with AFX-2, the active ingredient of our lead product COLD-FX. We have initiated a process to file AFX-2 with the Chinese State Food and Drug Administration ("SFDA") within the current fiscal year. The drug registration and approval process with SFDA is estimated to take three to five years as the process requires additional pre-clinical and clinical trials. However, due to Health Canada's approval and history of human consumption of COLD-FX, we estimate that this process will be able to be expedited given our ability to meet standard SFDA requirements (see "Advisory Regarding Forward-looking Statements").

QUARTER OVERVIEW

Revenue for the three months ended June 30, 2011 was \$4.6 million, an increase of \$2.8 million from revenue of \$1.8 million achieved in the same three-month period of fiscal 2011. Typically, the quarter ending June 30 is our lowest revenue quarter as the incidence of cold and flu is usually at its lowest. In the periods prior to the first quarter of 2011, our retail customers had built significant inventory positions in anticipation of public concerns over H1N1. This resulted in revenue in the first quarter ended June 30, 2010 being lower than we would have normally expected while revenue in the most recently completed quarter is more in line with our expectations.

Consistent with the increase in our revenue during the quarter, our net loss was reduced to \$3.1 million. This compares to a net loss of \$4.1 million incurred in the comparative quarter ended June 30, 2010. The first quarter of our fiscal year corresponds to a period where the sales of cold and flu products are at their seasonal low and revenues are not typically sufficient to cover overhead expenses.

COLD-FX continues to be the number one pharmacist and doctor recommended natural cold remedy as reported by Drugstore Canada's and L'actualite Pharmaceutique's 2009 / 2010 Survey on OTC Counseling and Recommendations and The Medical Post's 2010 Survey on OTC Counseling & Recommendations, respectively. In addition, COLD-FX remains the number one selling cold and flu remedy in Canada for the 52 week period ended July 2, 2011, per Point of Sale Data received from the Nielsen Company.

In the second quarter of fiscal 2011, we paid out our mortgage and, other than an obligation under a finance lease, we no longer have any long-term debt. We commenced utilizing an operating line of credit to fund working capital at the end of this quarter utilizing \$2.7 million of a \$15 million line by June 30, 2011. We expect to return to a surplus cash position by the third quarter of fiscal 2012 based on seasonal shipments of product and collection of receivables (see "Advisory Regarding Forward-Looking Statements"). We believe our future revenue stream combined with our cash balances and operating line of credit, will be sufficient to fund both our working capital needs and research and development activities for the foreseeable future (see "Advisory Regarding Forward-Looking Statements").

SUMMARY OF CONSOLIDATED FINANCIAL RESULTS

The following table summarizes key financial data from our consolidated financial statements for the three months ended June 30, 2011:

Summary of Consolidated Financial Results

	Three months ended June 30, 2011	Three months ended June 30, 2010
<i>(in thousands except for per share amounts)</i>		
Revenue	\$ 4,574	\$ 1,758
Cost of goods sold	1,682	951
Gross profit	2,892	807
Gross margin %	63.2%	45.9%
EBITDA ¹	(3,822)	(5,152)
Net loss	(3,137)	(4,110)
Loss per share – basic and diluted	(0.03)	(0.04)
Cash flow prior to working capital changes ¹	(2,975)	(3,175)
	As at June 30, 2011	As at March 31, 2011
Working capital ¹	\$ 9,255	\$ 12,224
Total assets	36,305	36,236
Total long-term debt and obligations under capital lease (including current portion)	858	843
Shareholders' equity	22,558	25,591

¹ These financial measures are identified and defined under the section "Non-IFRS Financial Measures".

REVENUE

Revenue during the quarter ended June 30, 2011 was \$4.6 million as compared to revenue of \$1.8 million generated during the same three-month period ended June 30, 2010. In the quarter ended June 30, 2010, replenishment orders were low as many retail customers entered the quarter well-stocked with COLD-FX due to retailers having built their inventory position of COLD-FX in response to public concerns over H1N1 in earlier periods. These concerns were significantly abated when the incidence of flu subsequently decreased. Revenue in the most recently completed quarter is more in line with our expectations for this quarter.

GROSS MARGIN

Gross profit of \$2.9 million in the first quarter of fiscal 2012 is \$2.1 million greater than the gross profit of \$0.8 million recognized in the prior year's first quarter. The increase in gross profit dollars is primarily due to the increase in revenue; however, gross margin as a percentage of revenue also increased to 63.2% from 45.9% as compared to the same quarter in 2010 due to the averaging down of fixed manufacturing expenses over the higher revenue experienced in the first quarter of this year. Offsetting further gains in gross margin in the quarter were write-downs of inventory totaling \$0.2 million (June 2010 – \$0.2 million).

SALES AND MARKETING

Sales and marketing expenses increased to \$2.8 million during the three-month period ended June 30, 2011 from \$2.3 million in the corresponding period ended June 30, 2010 primarily due to marketing activities related to the launch of COLDSORE-FX and an increase in the purchase of market data to assist in brand analysis. Many of our marketing program expenditures typically follow a seasonal pattern tied to sales of COLD-FX. In comparison to other quarters of the fiscal year, our first quarter typically experiences low revenue and correspondingly, marketing expenditures are lower. A significant portion of the sales and marketing expenses incurred this quarter are fixed in nature and relate to office and personnel costs.

GENERAL AND ADMINISTRATION

General and administration ("G&A") expenditures for the quarter ended June 30, 2011 were \$2.6 million compared to \$2.3 million for the same quarter in the prior period. This increase is attributed to an increase in personnel hired in the last quarter of fiscal 2011 and an increase in accounting and audit fees related to the adoption of IFRS.

RESEARCH AND DEVELOPMENT

Research and development ("R&D") costs for the three month period ended June 30, 2011 and June 30, 2010 are approximately the same at \$1.6 million. For the three months ended June 30, 2011, personnel costs increased to support our pipeline development, clinical trial work and advancement of our international opportunities. These increased costs were offset by increased recognition of scientific research and experimental development ("SRED") tax credits in the quarter of \$0.2 million (June 2010 – \$0.1 million).

EARNINGS BEFORE INCOME TAXES, DEPRECIATION AND AMORTIZATION ("EBITDA")

For the quarter ended June 30, 2011, we incurred an EBITDA loss (see "Non-IFRS Financial Measures") of \$3.8 million compared to an EBITDA loss of \$5.2 million for the quarter ended June 30, 2010. The decrease in the loss is due to higher revenue in the current quarter of fiscal 2012 offset partially by higher overall expenses. The first quarter of our fiscal year corresponds to a period when the sale of cold and flu products are at their seasonal low and revenues are not typically sufficient to cover overhead expenses.

FINANCE COSTS

In the second quarter of fiscal 2011, we paid out our mortgage and, other than an obligation under a finance lease, we no longer have long-term debt. Interest incurred in the current quarter of \$32 thousand is primarily due to this obligation under finance lease and bank charges for having a line of credit available for use. We also commenced utilizing an operating line of credit to fund working capital at the end of this quarter and therefore \$2 thousand of interest was incurred from this line. The \$80 thousand of finance costs incurred in the first quarter of fiscal 2011 is primarily due to interest on the mortgage, which is now paid out, and the obligation under finance lease.

INCOME TAXES

An income tax recovery of \$1.0 million is recorded for the first three months of fiscal 2012 compared to \$1.4 million for the first three months of fiscal 2011. The change is primarily due to a lower first quarter loss. The current period's effective tax rate of 24% is lower than the 26% rate recorded in the corresponding period in fiscal 2011 primarily due to a decrease in reserves related to revenue allowances.

NET EARNINGS

We incurred a net loss of \$3.1 million during the three month period ended June 30, 2011 compared to a net loss of \$4.1 million reported in the same period ended June 30, 2010. The decrease in the loss is due to higher revenue in the current quarter of fiscal 2012 offset partially by higher overall expenses. The first quarter of our fiscal year corresponds to a period when the sale of cold and flu products is at their seasonal low and revenues are not typically sufficient to cover overhead expenses.

Quarterly Information

	For quarters ended							
	June 30 2011 IFRS	March 31 2011 IFRS	December 31 2010 IFRS	September 30 2010 IFRS	June 30 2010 IFRS	March 31 2010 Canadian GAAP	December 31 2009 Canadian GAAP	September 30 2009 Canadian GAAP
Revenue	\$ 4,574	\$ 6,084	\$ 12,691	\$ 19,232	\$ 1,758	\$ 4,827	\$ 29,547	\$ 15,557
Net (loss) earnings	(3,137)	(2,548)	1,055	4,777	(4,110)	(4,027)	6,816	2,782
(Loss) earnings per common share – basic and diluted	(0.03)	(0.03)	0.01	0.05	(0.04)	(0.04)	0.06	0.03

Most of our revenue is from the sale of COLD-FX. Sales of this product exhibit a seasonal pattern tied to the frequency and severity of colds and flu, as well as other factors including weather. This affects the volume and timing of sales. The quarter ended September 30 corresponds to the time that most of our major customers commence stocking up on cold and flu products in anticipation of demand in the late fall and winter months when, historically, the incidence of colds and flu rises. Further orders are made for restocking of product once the cold and flu season commences, which typically corresponds to our quarter ended December 31. Our quarter ended March 31 corresponds to the time that the incidence of colds and flu are on the decline. The quarter ended June 30 is historically the quarter with the lowest revenue as the incidence of colds and flu is typically at its lowest.

We believe that in the quarters ended September 30, 2009 and December 31, 2009, public awareness of flu increased with a higher incidence of flu and the associated World Health Organization announcement, and media coverage thereon, of H1N1, a pandemic strain of the flu. Revenue and net earnings increased in these quarters as compared to the corresponding prior year's quarters because of an increase in demand for COLD-FX during this period. In the quarters ended March 31, 2010 and June 30, 2010, concerns over H1N1 declined and retailers were well-stocked with cold and flu products. Fewer incidents of flu resulted in lower retailer sale volumes of cold and flu products and as a result, restocking orders for COLD-FX were relatively low in these periods. During the quarter ended September 30, 2010, revenue again increased as retail customers began stocking up on cold and flu products prior to the fall and winter cold and flu season. During the quarter ended December 31, 2010, revenue was lower than normal for this time of year as retailers entered the quarter well-stocked with COLD-FX and the incidence of colds and flu was lower than in the same quarter last year. In the quarters ended March 31, 2011 and June 30, 2011, revenue declined from the prior quarters ended September 30, 2010 and December 31, 2010 as these quarters are outside of or at the end of the cold and flu season and retailers managed down their product inventory levels.

SUBSEQUENT EVENTS

On August 10, 2011, we were informed that Paladin Labs Inc. ("Paladin") filed documents with the Canadian securities authorities formally commencing an unsolicited tender offer to acquire all the outstanding common shares of Afexa for either cash consideration of \$0.55 per common share or 0.013 of a Paladin share for each common share ("the Offer"). Paladin is a holder of approximately 14.9% of Afexa's issued and outstanding common shares as at July 15, 2011. In response to the unsolicited offer the Company issued a press release stating that "the Company's Board of Directors believes the Paladin Offer significantly undervalues Afexa's business." The Board of Directors of Afexa has established a special committee of the Board to review the Offer and will issue a Directors' Circular concerning the Paladin Offer.

On August 14, 2011, we adopted a new shareholder rights plan (the "New Rights Plan"). The New Rights Plan has been adopted to limit, to the extent possible, the ability of any investor to obtain effective control of Afexa through coercive and opportunistic methods without making a take-over bid offer to all shareholders of Afexa which a majority of shareholders find acceptable and otherwise to encourage fair treatment of shareholders in connection with any take-over bid offer for Afexa's common shares.

LIQUIDITY AND CAPITAL RESOURCES

Our main source of capital during the period ended June 30, 2011 was our cash on hand provided from operating activities in prior periods and utilization of our demand operating line of credit. The primary use of our cash was the funding of operating activities as a net loss was incurred in the period. In addition to our net loss, we used cash on hand to fund the seasonal production build-up of our inventory prior to the upcoming fall cold and flu season. We also used cash on hand to finance capital expenditures.

Our working capital and capital expenditure requirements depend upon numerous factors including, but not limited to, the success and timing of the introduction of new products or entry into new markets, consumer demand, risk of sales returns, timing of market development programs, and long-term focus on product research and development activities. We believe that future cash generated from operating activities and the availability of our operating line of credit (see "Aggregate Contractual Obligations and Off-balance Sheet Financing") will be sufficient to fund both our future working capital needs and research and development activities beyond the next twelve months (see "Advisory Regarding Forward-looking Statements").

Selected Cash Flow and Capitalization Data

<i>(in thousands)</i>	Three months ended June 30, 2011	Three months ended June 30, 2010
Cash flow prior to working capital changes ¹	\$ (2,975)	\$ (3,175)
Cash used in operating activities	(6,124)	(8,715)
	As at June 30, 2011	As at March 31, 2011
Net demand operating line of credit and cash	\$ (2,496)	\$ 3,691
Working capital ¹	9,255	12,224
Long-term debt and obligations under finance lease (including current portion)	858	843

¹ These financial measures are identified and defined under the section "Non-IFRS Financial Measures".

CASH, DEMAND OPERATING LINE OF CREDIT AND WORKING CAPITAL

At June 30, 2011, we had \$0.2 million of cash on hand and utilized \$2.7 million of a \$15 million demand operating line of credit. This compares to \$3.7 million in cash and no utilization of our demand operating line of credit at March 31, 2011. During the quarter, we used cash on hand and the operating line to fund our operations, build up inventory levels for the upcoming cold and flu season, and purchase a limited amount of tangible and intangible long-term assets.

Our working capital position at June 30, 2011 was \$9.3 million (March 31, 2011 – \$12.2 million). The decrease of \$2.9 million from March 31, 2011 is primarily due to our net loss realized in the quarter.

CASH USED IN OPERATING ACTIVITIES

Cash flow prior to working capital changes was negative \$3.0 million in the quarter compared with negative \$3.2 million in the prior year. Our lower net loss in the current period is the primary reason for the lower negative draw on cash flow prior to working capital between the two periods. Including changes in working capital items, we utilized \$6.1 million in cash from operating activities in the three months ended June 30, 2011 as we also used cash on hand to build up inventory levels.

CASH USED IN INVESTING ACTIVITIES

Capital expenditures for the three months ended June 30, 2011 included purchases of property and equipment of \$20 thousand and additions to intangible assets of \$31 thousand. These expenditures were primarily miscellaneous office equipment as well as for patent and trademark costs associated with new product development.

CASH USED IN FINANCING ACTIVITIES

During the period ended June 30, 2011, we repurchased common shares under our NCIB resulting in net cash used in financing activities of \$12 thousand.

NORMAL COURSE ISSUER BID ("NCIB")

On October 18, 2010, we renewed our NCIB with the Toronto Stock Exchange ("TSX"). Under the renewed NCIB, we may acquire up to 5,212,941 common shares, until the renewed NCIB expires on October 17, 2011.

During the period ended June 30, 2011, we repurchased and cancelled 30,626 common shares pursuant to the NCIB at a total cost of \$12 thousand or \$0.38 per common share.

It is management's intent to discontinue purchases under the NCIB during the period the Company is subject to an unsolicited bid (see "Advisory Regarding Forward-looking Statements").

AGGREGATE CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET FINANCING

We have a demand operating line of credit of \$15.0 million with interest at the bank's prime lending rate plus 0.75%. The portion of the line of credit that is available to us is based on 65% of the appraised value of the Edmonton, Alberta head office and research centre to a maximum limit of \$6.8 million, 75% of accounts receivable aged less than 90 days, plus 50% of finished goods inventory to a maximum limit of \$4.1 million.

We also have an obligation under finance lease related to land which our Edmonton, Alberta head office and research facility is located on. The finance lease expires on November 15, 2015, and provides us an option to purchase the land on or before that time. We expect to exercise this option on or before the expiration of the lease (see "Advisory Regarding Forward-looking Statements").

In addition, we enter into operating and finance leases and purchasing agreements in the ordinary course of our business, including various agreements to provide financial assistance in research and development activities and clinical studies. To encourage a contract manufacturer organization ("CMO") to invest in specific equipment required to produce our products, we signed on May 26, 2010 a commitment to purchase \$3.0 million of inventory from this CMO over a three-year period with \$2,730 remaining on this commitment. On March 24, 2011, we entered into an agreement with another CMO to develop a new product. If we proceed with launching this product, the contractual terms provide for a commitment of \$1.2 million.

We continue to project that capital expenditures for the year ending March 31, 2012 will be approximately between \$1.0 million to \$1.5 million, which will primarily consist of lab, office, and computer equipment (see "Advisory Regarding Forward-looking Statements").

RELATED PARTY TRANSACTIONS

No related party transactions occurred during the three months ended June 30, 2011. Included in general and administration expenses were management consulting fees of \$32 thousand for the three months ended June 30, 2010 incurred from a company controlled by a director of Afexa. These expenses occurred in the normal course of operations and were measured at their exchange amounts, which were established and agreed to as consideration by the related parties.

OUTSTANDING SHARES AND SHARE OPTIONS

We are authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at August 18, 2011, 103,171,926 common shares were outstanding (June 30, 2011 – 103,171,926 and March 31, 2011 – 103,202,552). No preferred shares were outstanding during or at the end of these periods. Certain of our employees, officers, contractors and directors have been granted options to purchase common shares under our share option plan. At August 18, 2011, 6,727,914 options were outstanding (June 30, 2011 – 6,761,664 and March 31, 2011 – 7,105,914).

OUTLOOK

Moving into fiscal 2012, we believe revenue will improve over last year's results. We believe retailer and consumer inventory levels of COLD-FX have normalized and therefore, we expect revenue growth to be more comparable to historic periods when sales were not as significantly impacted by the pandemic outbreak of the flu. We have also expanded our product portfolio with the launch of COLDSORE-FX, which will add to our expected revenue growth (see "Advisory Regarding Forward-looking Statements").

We expanded our sales capabilities in Ontario by contracting for a direct sales force in June 2011 similar to that being used in Quebec. Ontario and Quebec are geographic locations where we expect revenue to grow (see "Advisory Regarding Forward-looking Statements").

We continue to pursue regulatory approval for the sale of the core ingredient of COLD-FX (CVT-E002) in China and have begun pursuing strategic partnerships to out-license commercial rights for this region. Strategic commercial partnerships are also being sought for CVT-E002 in other regions, including Japan (see "Advisory Regarding Forward-looking Statements").

Health Canada has approved the continuation of our pediatric trial of COLD-FX and we expect to complete recruiting for this trial during this upcoming cold and flu season (see "Advisory Regarding Forward-looking Statements").

The FDA provided Investigational New Drug clearance for AFX-2, a Phase 1B clinical trial investigating the reduction, duration and frequency of cold and flu symptoms among CLL patients. Patient enrolment is expected to commence this fiscal year (see "Advisory Regarding Forward-looking Statements").

DISCLOSURE CONTROLS AND PROCEDURES ("DC&P") AND INTERNAL CONTROLS OVER FINANCIAL REPORTING ("ICFR")

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings. We evaluate our DC&P and ICFR using the framework established in the Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Information Technology controls are evaluated using the Control Objectives for Information and Related Technology (COBIT®) framework.

There have been no changes in our internal control over financial reporting during the three months ended June 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

LIMITATIONS ON THE EFFECTIVENESS OF INTERNAL CONTROLS

Material misstatements due to error or fraud may not always be prevented or detected on a timely basis because of the inherent limitation of DC&P and ICFR, including the possibility of collusion or improper management override of controls. Inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. In addition, the design of a control system must reflect the fact that there are resources constraints, and the benefits of controls must be considered relative to their costs. Management will continue to monitor and improve internal controls as necessary and appropriate for the business. Further discussion regarding DC&P and ICFR can be found in our March 31, 2011 annual MD&A.

RISKS AND UNCERTAINTIES

Our business is subject to certain risks and uncertainties related to financial risks (including liquidity, interest rate, foreign exchange, credit and litigation risk); operational risks (including market, product, seasonality of demand, product development, material supply and reliance on third party risks); regulatory approvals, and health and safety risks. Further discussion regarding these and other risks can be found in our March 31, 2011 annual MD&A and our Annual Information Form dated June 24, 2011 available on the SEDAR website at www.sedar.com.

Prior to making any investment decision regarding Afexa, investors should carefully consider, among other things, the risks described within this MD&A and the business risks and factors set forth in our March 31, 2011 annual MD&A and Annual Information Form dated June 24, 2011. Other than, as discussed elsewhere in this MD&A, our business risks and factors for the three months ended June 30, 2011 are substantially the same as disclosed in our annual MD&A, and are incorporated by reference herein. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business and operations.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements in accordance with IFRS requires management to make various estimates and assumptions. Critical accounting estimates are those assumptions and estimates that are most important in the preparation of the interim consolidated financial statements. The selection of policies requires subjective and complex judgment from many alternatives and estimates involving matters that are inherently uncertain. Those assumptions and estimates affect the reported amounts of assets and liabilities and revenue and expenses during the periods presented. Actual results could differ from these estimates.

Management believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of the accompanying interim consolidated financial statements:

- Revenue recognition;
- Long-lived assets and impairment;
- Depreciation and amortization;
- Accrued liabilities;
- Provisions
- Income taxes;
- Inventory valuation; and
- Share-based payments.

On an ongoing basis, management reviews its estimates to ensure that these values appropriately reflect changes in our business and new information as it becomes available. Revisions to accounting estimates are recognized in the period in which the estimate is revised. Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the annual consolidated financial statements include, but are not limited to, the following:

REVENUE RECOGNITION

We establish allowances for estimated rebates, charge-backs and product returns based on numerous qualitative and quantitative factors, which include:

- The number of and specific terms of arrangements with customers;
- Estimated levels of inventory in the distribution channel;
- Historical rebates, coupon redemption rates, charge-backs and returns of products;
- Direct communication with customers;
- Anticipated introduction of competitive products;
- Anticipated pricing strategy changes by us and/or our competitors;
- Analysis of retail sell-through;
- The effect of regulatory changes; and
- The estimated remaining shelf life of products.

Consistent with industry practice, we periodically offers promotional discounts or allowances to the existing customer base. Where products are sold into new markets or new products are launched, our policy is to recognize revenue when the risk of return is substantially eliminated, which is typically based on estimates of sell-through to the end consumer.

Customer discounts and allowances are typically either a percentage of the current published list price or a fixed amount, and are treated as off-invoice allowances. Accordingly, discounts reduce revenue in the period the program is offered. Discounts and allowances vary by customer, marketing program and time of the year.

LONG-LIVED ASSETS AND IMPAIRMENT

Impairment exists when the carrying value of an asset or cash generating unit (“CGU”) exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm’s length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that we are not yet committed to or significant future investments that will enhance the asset’s performance of the CGU being tested.

The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes. To arrive at cash flow projections, we use estimates of economic and market information over the projection period, including growth rates in revenues, estimates of future expected changes in operating margins, and cash expenditures. Other significant estimates and assumptions include future estimates of capital expenditures and changes in future working capital requirements.

DEPRECIATION AND AMORTIZATION

We depreciate property and equipment and amortize intangible assets over the estimated useful lives of the assets. We take into account expectations of the in-service period of these assets in determining these estimates. We assess the estimated useful life of these assets on an annual basis to ensure they match the anticipated life of an asset from a revenue producing perspective. If we determine that the useful life of an asset is different from the original assessment, changes to depreciation and amortization will be applied prospectively.

ACCRUED LIABILITIES

We engage a significant number of third party service providers, contract manufacturers and logistics organizations. Accruals are made based on estimated expenses and/or inventory production. Where possible, detective controls, such as confirmations, are used to verify significant accruals. The accruals depend on the issuance and accuracy of estimates in purchase orders and contracts, and the accuracy of estimates on the percentage of completion and costs incurred to the end of the reporting period.

INVENTORY VALUATION

Work-in-progress costs include our allocation of overhead. This allocation is based on estimated annual production levels. Production levels are substantially driven by current and future estimated demand for our products, as well as our supply chain strategy.

Inventories have a finite shelf life. Raw materials, work in progress and finished goods have expiry dates and are subject to competitive pricing, obsolescence, and spoilage. Inventory is reviewed for obsolescence at least on a quarterly basis, and where identified, the excess of carrying amount over net realizable value is expensed to cost of goods sold. Inventory valuation allowances primarily relate to packaging material and excess inventories that would not be useable with planned changes to product branding and current revenue forecasts.

Interim reporting under IAS 34 specifies that price, efficiency, spending, and volume variances are recognized in earnings at interim reporting dates to the same extent that those variances are recognized in income at financial year end. Deferral of variances that are expected to be absorbed by year end is not appropriate because it could result in reporting inventory at the interim date at more or less than its portion of the actual cost to manufacture. Under IFRS, we still assess normal capacity on an annual basis; however, any unallocated overhead variances have been recorded to cost of goods sold during the interim period.

SHARE-BASED PAYMENTS

We measure the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payments requires the determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. We use a Black-Scholes option-pricing model.

This fair value estimate also requires determining the most appropriate inputs to the valuation model including the estimated expected life of the share option, volatility, and dividend yield. The expected volatility is based on the historical volatility of our shares over a period commensurate with the expected term of the share option. The risk-free interest rate for the expected life of the option is based on the yield available on government bonds, with an approximate equivalent remaining term at the end of the grant. Historical data is used to estimate the expected life of the option. As well, we estimate our forfeiture rate for equity-settled transactions based on historical experience in order to determine the compensation expense arising from the share-based awards.

INCOME TAXES

We are subject to taxation in numerous jurisdictions. There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. We maintain provisions for uncertain tax positions that we believe appropriately reflect our risk with respect to tax matters under active discussion, audit, dispute or appeal with tax authorities, or which are otherwise considered to involve uncertainty. These provisions are made using the best estimate of the amount expected to be paid based on qualitative assessment of all relevant factors. We review the adequacy of these provisions at the end of each reporting period; however, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

CHANGES IN ACCOUNTING POLICIES INCLUDING TRANSITION TO IFRS

TRANSITION TO IFRS

During the fiscal year ended September 30, 2009, we commenced our process to transition to IFRS utilizing an implementation plan which encompassed, but was not limited to, evaluation of the IFRS standards, assessment of policy alternatives and elections, selection and application of accounting policies, integration and quantification of those policies into our business and financial statements and collection of all financial information necessary to produce IFRS compliant financial statements. Throughout this process, management established sufficient controls to ensure the accuracy, completeness and reliability of financial information and compliance with the new reporting standards. As part of this implementation plan, we also assessed and concluded that our information technology and data systems, internal control over financial reporting and disclosure controls and procedures, and business activities were minimally impacted by IFRS. Our conversion process is summarized in our March 31, 2011 annual MD&A under the Recent Accounting Pronouncements section.

The unaudited interim consolidated financial statements for the three months ended June 30, 2011 are the first presentation of our results and financial position in accordance with IFRS. Subject to certain transition elections disclosed below, we have consistently applied the same accounting policies in our opening IFRS statement of financial position at April 1, 2010 and throughout all periods presented as if these policies have always been in effect.

Although the conceptual framework of IFRS is similar to that of Canadian GAAP, there are some significant differences on recognition, measurement, and disclosure. The impact of IFRS on our unaudited interim consolidated statement of position and consolidated statement of loss and comprehensive loss is summarized below. There are no differences between cash flows reported under Canadian GAAP to those reported under IFRS for the year ended March 31, 2011 or the quarter ended June 30, 2010. Our transitional elections, accounting policy choices, and their impact on the financial statements are described in full in note 29 of the interim consolidated financial statements.

(a) IFRS 1 Exemptions

The majority of adjustments required on the transition to IFRS were made retrospectively against opening deficit at April 1, 2010. IFRS 1 – *First-Time Adoption of International Financial Reporting Standards* provides entities adopting IFRS for the first time with a number of optional and mandatory exemptions to the general requirement for full retrospective application of IFRS. We have applied the following exemptions:

- *Cumulative translation differences*

We elected to set the cumulative currency translation difference for all our foreign operations to be \$nil at April 1, 2010. This election had no net impact on our opening shareholders' equity.

- *Share-based payments*

We have elected not to retrospectively apply IFRS 2 – *Share-Based Payments* to the equity instruments granted on or before November 7, 2002, or granted after November 7, 2002 that vested before April 1, 2010.

For our cash-settled share-based payment transactions, which include deferred share units and restricted share units, we have elected not to retrospectively apply IFRS 2 to any liabilities settled before April 1, 2010.

- *Fair value as deemed cost*

We have elected to measure our land under finance lease and our building at their respective fair values as at April 1, 2010 and use those amounts as the assets' deemed cost. The land under finance lease and building balances were assessed by an independent valuator for land and building in existence as at April 1, 2010. The revaluation of the land under finance lease and building values were determined using a combination of direct comparisons with other similar properties and the cost approach method of valuation. For all other property and equipment assets, we continue to use the historical cost model. Our consolidated opening statement of financial position increased by \$0.5 million in property and equipment and decreased deficit by the same amount as a result of this change. We chose this election as certain of the building's significant components did not have historical costs easily determinable for componentization.

- *Business combinations*

We chose the business combination exemption in IFRS 1 not to apply IFRS 3 – *Business Combinations*, retrospectively to past business combinations for business combinations that took place prior to April 1, 2010.

(b) IFRS 1 Mandatory Exception to Retrospective Application

In preparing the consolidated financial statements in accordance with IFRS 1, we have applied the following mandatory exemption from full retrospective application of IFRS:

- *Estimates*

We did not use hindsight to create or revise estimates previously made under Canadian GAAP. Our IFRS estimates as of April 1, 2010 are consistent with our Canadian GAAP estimates for the same date.

(c) Accounting Policies and Financial Statement Presentation

Summarized below are the key differences in our accounting policies between Canadian GAAP and IFRS that had the most significant impact on our consolidated opening statement of financial positions at April 1, 2010 and 2011 comparative financial statements. The following discussion also includes an analysis of how the IFRS changeover is expected to affect our future financial reporting.

Impact of Adopting IFRS on the Statement of Financial Position

As at April 1, 2010

(in thousands)

Standard	Financial position category	Description of change	Increase (decrease) in shareholders' equity
IFRS 1	Property and equipment	Adjustment of land under finance lease and building to fair value	\$ 512
IAS 36	Intangible assets	Derecognition of website development costs	(206)
IAS 12	Deferred income taxes	Income tax impact of above adjustments	398
Total after-tax impact on shareholders' equity			\$ 704

Impact of Adopting IFRS on the Statement of Loss and Comprehensive Loss

For the three months ended June 30, 2010

(in thousands)

Standard	Income statement expense	Description of change	Increase (decrease) in net loss and comprehensive loss
IAS 16	Depreciation of property and equipment	Reduced depreciation of building due to fair value revaluation	\$ 30
IAS 36	Amortization of intangible assets/sales and marketing	Website amortization and write-down reversals and increases sales and marketing expense for website costs incurred	(73)
IFRS 2	Share-based payments	Reduced share-based payments due to calculating each tranche as a separate grant	(3)
IAS 12	Deferred income tax	Income tax impact of above adjustments	11
Total after-tax impact net loss and comprehensive loss			\$ (35)

Impact of Adopting IFRS on the Statement of Loss and Comprehensive Loss

For the year ended March 31, 2011

(in thousands)

Standard	Income statement expense	Description of change	Increase (decrease) in net loss and comprehensive loss
IAS 16	Depreciation of property and equipment	Reduced depreciation of building due to fair value revaluation	\$ 122
IAS 36	Amortization of intangible assets/sales and marketing	Website amortization and write-down reversals and increases sales and marketing expense for website costs incurred	3
IFRS 2	Share-based payments	Reduced share-based payments due to calculating each tranche as a separate grant	(91)
IAS 18	Revenue/sales and marketing	Recognition of revenue and expense for goods or services exchanged	–
IAS 12	Income tax expense	Income tax impact of above adjustments	(31)
Total after-tax impact net loss and comprehensive loss			\$ 3

Our basic and diluted earnings per share were not significantly affected by any of the above adjustments.

IFRS changes that impacted our comparative and current period include:

- *Presentation of financial statements (IAS 1)*

Under IAS 1, a complete set of financial statements should include a statement of financial position, a statement of comprehensive income, a statement of changes in equity, and a statement of cash flows, accounting policies, and explanatory notes. The adoption of IAS 1 resulted in the addition of a statement of changes in equity, expanded note disclosures, and different classification and presentation of line items within our consolidated statements of financial position and consolidated statements of loss and comprehensive loss.

On the statement of financial position, certain balances have been reclassified from the Canadian GAAP presentation. Future income taxes are now required to be shown as non-current assets or liabilities and have been renamed deferred income tax assets or liabilities. Balances previously included in accounts payable and accruals have also been reclassified to the provisions line item if they related to provisions.

IAS 1 also requires the consolidated statement of loss and comprehensive loss to be presented based on either the nature or function of the related income item. We have chosen to present the statement of loss and comprehensive loss based on function as this provides users with information that is most relevant to our business. Accordingly, depreciation, amortization and share-based payments are no longer presented separately, but allocated based on function and included as part of cost of goods sold, sales and marketing, general and administration, and research and development expenses. Gain or loss on foreign exchange, impairment of intangible assets and other expenses are also now reported in aggregate as other expenses. These reclassifications had a minimal impact on our debt covenants and key performance indicators.

- *Property, plant and equipment (IAS 16)*

As a result of our fair value adjustment to the land under finance lease and building, residual values and expected lives of certain components of the building were also adjusted based on the valuation performed. Our depreciation expense has decreased as the fair value of the building has decreased. Depreciation expense has decreased \$30 thousand for the three months ended June 30, 2011 and \$122 thousand for the year ended March 31, 2011.

- *Intangible assets (IAS 38)*

Standing Interpretation Committee ("SIC") 32 for IAS 38 does not allow capitalization of our websites as they are general marketing tools and are not considered to be used directly to generate income. \$206 thousand was derecognized as capitalized website costs as at the transition date and recorded to deficit. \$146 thousand in website additions were expensed to sales and marketing in the twelve months ended March 31, 2011 (three months ended June 30, 2010 – \$88 thousand), \$71 thousand was reversed for amortization taken under Canadian GAAP related to websites (three months ended June 30, 2010 – \$15 thousand), and \$78 thousand was reversed from other expenses related to write-downs of websites (three months ended June 30, 2010 – \$nil).

- *Share-based payment (IFRS 2)*

We previously calculated the fair value of share-based awards with graded vesting as one grant recognizing the fair value on a straight-line basis over the entire vesting period under Canadian GAAP. Forfeitures of awards were also recognized as they occurred. IFRS 2 requires that awards with multiple vesting dates are graded with each vesting period treated as a separate tranche. The fair value of each tranche is then calculated separately and is amortized over the vesting period of the respective tranches. Also, award forfeitures are estimated as part of share-based compensation expense. The change in treatment of share-based awards has resulted in an increase of \$271 thousand to contributed surplus at April 1, 2010. For the twelve months ended March 31, 2011, the contributed surplus balance increased by a total of \$362 thousand over the Canadian GAAP balance.

- *Revenue (IAS 18)*

When goods or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue under IAS 18. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred. There was no such requirement under Canadian GAAP to recognize revenue when such an exchange occurred. As a result, for the twelve months ended March 31, 2011, the Company has recorded increased revenue of \$169 thousand, increased cost of goods sold of \$32 thousand, and additional sales and marketing expenses of \$137 thousand for goods that were exchanged for services (three months ended June 30, 2010 – \$nil).

IFRS that may have future impacts on our consolidated financial statements:

- *Leases (IAS 17)*

Lease accounting under IFRS and Canadian GAAP follow similar approaches whereby leases are either capitalized and amortized over the life of the lease (finance leases) or lease payments are expensed as incurred (operating leases). Under both IFRS and Canadian GAAP, a lease is classified as a finance lease if it transfers substantially all of the risks and rewards incidental to ownership. As a result, no adjustments were required on transition.

In August 2010, the IASB and FASB issued a joint exposure draft relating to leases. They are proposing that the finance lease approach be adopted for all leases, meaning all leases would be shown as an asset and liability on the statement of financial position and amortized over the life of the lease. The impact on Afexa could be significant given the length of one of our property leases. The Boards continue to receive comments on the proposed standard and plan on issuing the new standard in the fourth quarter of calendar 2011. We continue to monitor developments in this area.

- *Impairment of assets (IAS 36)*

Under IAS 36, Intangible assets with indefinite lives and intangible assets that are not in use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired. The impairment test for finite-lived assets requires us to compare the recoverable amount of an asset (on a discounted basis) with the carrying amount. Canadian GAAP assesses impairment by comparing the carrying amount of an asset to the expected undiscounted cash flows for the asset. If the carrying amount is more than the undiscounted cash flows, the fair value of the asset is determined. An impairment loss is recorded if the carrying amount is more than the fair value.

This may potentially result in write-downs when the discounted cash flows are less than the carrying amounts of the assets, even if the undiscounted cash flows are greater than the carrying value. We assessed the carrying value of our assets in accordance with IAS 36 and found that no impairment losses were required to be recognized as at the date of transition, April 1, 2010, or during our comparative periods.

(d) Recent Accounting Pronouncements

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. This listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. Afexa intends to adopt those standards when they become effective.

IAS 12 Income Taxes — Recovery of Underlying Assets

This exposure draft was issued in September 2010 and contains a proposal by the IASB to amend IAS 12 Income Taxes (Deferred Tax: Recovery of Underlying Assets). The purpose of the amendments is to provide an exception to the principle that the measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities. The proposed amendments state that, in specified circumstances, the measurement of deferred tax liabilities and deferred tax assets should reflect a rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely by sale. This standard is required to be applied for accounting periods beginning on or after January 1, 2012, with earlier adoption permitted. The exception is currently meant to apply to only specified property and equipment or investment properties that apply the fair value or re-measurement model. The amendment to IAS 12 is not expected to have a significant impact on our consolidated financial statements.

IFRS 7 Financial Instruments: Disclosures – Enhanced Derecognition Disclosure Requirements

The amendment requires additional disclosures about financial assets that have been transferred, but not derecognized, to enable the user of the Company's financial statements to understand the relationship with those assets that have not been derecognized and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognized assets to enable the user to evaluate the nature of and risks associated with, the entity's continuing involvement in those derecognized assets. The amendment becomes effective for annual periods beginning on or after July 1, 2011, with earlier adoption permitted. The amendment affects disclosure only and therefore has no impact on our financial position or performance.

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after January 1, 2015, with earlier adoption permitted. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The completion of this project is expected over the course of calendar 2011. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of our financial assets, but will potentially have no impact on classification and measurements of financial liabilities. We are currently in the process of evaluating the implications of this new standard.

IFRS 10 Consolidated Financial Statements

IFRS 10 replaces the portion of IAS 27 – Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC 12 Consolidation – Special Purpose Entities. What remains in IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. IFRS 10 establishes a single control model that applies to all entities (including special purpose entities, or structured entities). The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Under IFRS 10, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. This principle applies to all investees, including structured entities. IFRS 10 is effective for annual periods commencing on or after January 1, 2013. We are currently in the process of evaluating the implications of this new standard.

NON-IFRS FINANCIAL MEASURES AND RECONCILIATIONS

We use both IFRS and certain non-international financial reporting standards (“non-IFRS”) measures to assess performance. We believe these non-IFRS measures provide useful supplemental information to investors so they may evaluate our financial performance using the same measures as management. We believe that, as a result, information provided to the investor is more transparent in assessing the financial performance of the Company. Investors should not consider these non-IFRS financial measures to be a substitute for, or superior to, the measures of financial performance prepared in accordance with IFRS.

Normally, a non-IFRS financial measure is a numerical measure of our performance, financial position or cash flow that either excludes or includes amounts not normally excluded or included in the most directly comparable measure calculated and presented in accordance with IFRS. Working capital, EBITDA, and cash flow prior to working capital changes are not measures of financial performance (nor do they have standardized meanings) under IFRS. In evaluating these measures, investors should consider that the methodology applied in calculating such measures may differ among companies and analysts.

WORKING CAPITAL

The definition of working capital is current assets less current liabilities. We use working capital as a supplemental financial measure of our liquidity and operational performance.

<i>(in thousands)</i>	As at June 30, 2011	As at March 31, 2011
Current assets	\$ 21,845	\$ 21,739
Current liabilities	12,590	9,515
Working capital	\$ 9,255	\$ 12,224

EBITDA

EBITDA is defined as earnings before interest, income taxes, depreciation and amortization. We use EBITDA as a supplemental financial measure of our operational performance. We believe EBITDA to be an important measure as it excludes the effects of items that primarily reflect the impact of long-term investment decisions, rather than the performance of our day-to-day operations, and a variant of this number is used by our lenders in computing certain bank covenants. As compared to net earnings according to IFRS, this measure is limited in that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in our business. We evaluate such items through other financial measures such as capital expenditures and cash flow provided by operating activities. We believe this measurement is useful to assess a company's ability to service debt and to meet other payment obligations and as a valuation measurement.

The following is a reconciliation of EBITDA to net earnings, the most directly comparable financial measure calculated and presented in accordance with IFRS:

<i>(in thousands)</i>	Three months ended June 30, 2011	Three months ended June 30, 2010
Net loss	\$ (3,137)	\$ (4,110)
Current income tax recovery	(788)	(1,730)
Deferred income taxes (recovery)	(208)	287
Depreciation and amortization	282	338
Interest and bank charges	32	80
Interest income	(3)	(17)
EBITDA	\$ (3,822)	\$ (5,152)

CASH FLOW PRIOR TO WORKING CAPITAL CHANGES

We use cash flow prior to working capital changes as a supplemental financial measure in our evaluation of liquidity. We believe adjusting principally for the changes in non-cash working capital items due to seasonality assists management in making long-term liquidity assessments. We also believe this measurement is useful as a liquidity and valuation measurement.

Below is a reconciliation of "cash flow prior to working capital changes" to cash used in operating activities, the most directly comparable financial measure calculated and presented in accordance with IFRS:

<i>(in thousands)</i>	Three months ended June 30, 2011	Three months ended June 30, 2010
Cash used in operating activities	\$ (6,124)	\$ (8,715)
Change in non-cash operating working capital	3,149	5,540
Cash flow prior to working capital changes	\$ (2,975)	\$ (3,175)

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of any of the words “expect”, “anticipate”, “continue”, “estimate”, “objective”, “ongoing”, “may”, “will”, “would”, “project”, “could”, “should”, “contemplate”, “potential”, “depend”, “forecast”, “believe”, “plans”, “targets”, “intends” and similar expressions are intended to identify such forward-looking statements. These forward-looking statements reflect our beliefs and are based on information currently available to us. These statements require us to make assumptions that we believe are reasonable and are subject to inherent risks and uncertainties. Actual results and developments may differ materially from the results and developments discussed in the forward-looking statements as certain of these risks and uncertainties are beyond our control. The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon.

Examples of such forward-looking statements in this MD&A include, but are not limited to, our:

- belief that the globalization of COLD-FX will be successful given the need for clinically proven and safe natural cold and flu products in markets beyond Canada;*
- intention to continue to use the clinical development rigour expected of OTC products in Canada;*
- belief that our products will be less expensive and take less time to develop under an FDA pathway;*
- expectation to partner at various stages of development;*
- belief that products under development will complete IND submission and NDA within certain timelines;*
- strategic plan being designed to deliver to our shareholders average annual revenue growth in excess of 10% by the end of the next five years;*
- belief that our new cold sore product will be beneficial to the significant number of Canadians that suffer from recurring cold sores;*
- anticipation that the drug registration and approval process with SFDA will be able to be expedited;*
- expectations that we will be in a surplus cash position by the third quarter of fiscal 2012;*
- belief that we will have sufficient cash and operating line availability to fund both our working capital needs and research and development activities for the foreseeable future;*
- intention to discontinue purchases under the NCIB during the period the Company is subject to an unsolicited bid;*
- expectation to exercise our option to purchase our land held under finance lease on or before the expiration of the lease;*
- projection that capital expenditures for the year ending March 31, 2012 will be between \$1.0 million and \$1.5 million;*
- expectation that revenue in fiscal 2012 will improve over last year’s results;*
- belief that our launch of COLDSORE-FX will add to our expected revenue growth in fiscal 2012;*
- anticipation that our revenue will grow in the provinces of Ontario and Quebec;*
- expectation that our field activity with the pediatric trial of COLD-FX will be completed during this upcoming cold and flu season; and*
- belief that we will commence the CLL Phase 1B clinical trial during this fiscal year.*

KEY ASSUMPTIONS

Our forward-looking statements involve a number of significant assumptions. Key assumptions utilized in developing forward-looking statements related to our future growth expectations include:

- *consumer demand for COLD-FX within Canada (including within the provinces of Quebec and Ontario) will experience continued growth on an annual basis;*
- *customer pricing and related discounts and allowances remain comparable with historical levels;*
- *raw material and production costs remain comparable with historical experience;*
- *timing of required regulatory approvals for new products is received within a reasonable timeframe;*
- *we are able to successfully launch certain products contained within our product pipeline into the Canadian marketplace, including, but not limited to, COLDSORE-FX; and*
- *the incidence of colds and flu among the Canadian population will be at normal levels in fiscal 2012 and that retailers will replenish COLD-FX stock on a normalized basis.*

RISKS

In addition to the risks outlined in the "Risks and Uncertainties" section of our MD&A, our forward-looking statements are subject to the following risks and uncertainties:

- *the incidence of illnesses in the general population;*
- *the impact of competition;*
- *consumer confidence and spending levels;*
- *general economic conditions;*
- *interest rates;*
- *unseasonable weather patterns;*
- *the cost and availability of capital;*
- *the cost and availability of grants/funding;*
- *product development;*
- *reliance on third parties;*
- *dependence on a small number of major customers;*
- *adequate cash position to mitigate potential tightening of credit terms;*
- *success and adequacy of our long-term strategic objectives; and*
- *risk that actual results may differ from management's assumptions and estimates.*

We believe the expectations and assumptions reflected in the forward-looking information and statements contained herein are reasonable. However, no assurance can be given that these expectations and assumptions are correct and that the results, performance or achievements expressed in, or implied by, forward-looking statements within this disclosure will occur, or if they do, whether any benefits may be derived from them. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.

The forward-looking information and statements contained in this MD&A speak only as at the date of this MD&A, and we assume no obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.