



Afexa Life Sciences Inc.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

For the year ended
March 31, 2011



Management's Discussion and Analysis

For the Year Ended March 31, 2011

The following Management's Discussion and Analysis ("MD&A") for Afexa Life Sciences Inc. ("Afexa" or "the Company"), prepared as of June 9, 2011, should be read in conjunction with the audited consolidated financial statements for the year ended March 31, 2011 and the notes contained therein. The accompanying consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. 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.

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-GAAP financial measures to assist users in assessing our performance. Non-GAAP financial measures do not have any standard meaning prescribed by GAAP and may not be comparable to similar measures presented by other issuers. These measures are identified and described under the section "Non-GAAP Financial Measures".

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

CHANGE IN YEAR-END

In the prior fiscal period, we changed our fiscal year-end from September 30 to March 31 to better align our financial reporting and business planning with our natural business cycle. As a result, the comparative figures in the accompanying consolidated financial statements reflect the six-month transitional year ended March 31, 2010 and the former financial year ended September 30, 2009. Accordingly, this twelve-month fiscal March 31, 2011 MD&A reflects comparisons with our fiscal 2010 as being the six months ended March 31, 2010 and fiscal 2009 as being the twelve months ended September 30, 2009. Where comparison to the twelve-month period ended March 31, 2010 is made, be advised that this period does not correspond to a period for which audited consolidated financial statements have been prepared.

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 identify precisely 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 testing 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 designed to aid in the prevention and relief of colds and flu 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 March 12, 2011).

YEAR OVERVIEW

- Revenue for the year ended March 31, 2011 was \$39.6 million. This compares to revenue of \$56.1 million during the same twelve-month period ended March 31, 2010. The high revenue reported during the twelve-month period ended March 31, 2010 was largely driven by the presence of H1N1, a pandemic strain of the flu, during that period;
- We reported a net loss of \$0.8 million or \$0.01 per share in fiscal 2011. The net loss was caused from lower revenue as well as higher expenditures in research and development incurred in the development of new products, which are expected to be launched in the future;
- In October 2010, we signed an in-license agreement whereby we were granted the exclusive Canadian rights to use, market, sell and distribute a proprietary natural health product for the treatment of cold sores. This product, which we have branded COLDSORE-FX™, is clinically proven to shorten the healing time and relieve the pain associated with cold sores. We plan to launch COLDSORE-FX into the Canadian marketplace this summer;
- We launched a multi-centre clinical trial to explore the potential application of COLD-FX in a pediatric population. The randomized, double-blind, placebo-controlled trial is rare in the field and is designed to assess the potential benefit of COLD-FX in reducing cold and flu symptoms and the burden of disease on children;
- In September 2010, we paid out our Edmonton facility mortgage of \$5.0 million. We also entered into a new credit facility agreement consisting of an operating line of credit of \$15.0 million, which was undrawn at year-end. With the exception of an obligation under capital lease of \$0.8 million, we were debt-free as at March 31, 2011; and
- In October 2010, we renewed our normal course issuer bid (“NCIB”) with the Toronto Stock Exchange. During the year ended March 31, 2011, we repurchased and cancelled 1,309,618 common shares at a weighted average trading price of \$0.53 per share.

Summary of Consolidated Financial Results

<i>(in thousands except for per share amounts)</i>	Year Ended March 31, 2011	Six Months Ended March 31, 2010	Year Ended September 30, 2009
Revenue	\$ 39,596	\$ 34,374	\$ 47,592
EBITDA ¹	401	5,189	3,761
Net (loss) earnings	(828)	2,789	1,301
(Loss) earnings per share – basic and diluted	(0.01)	0.03	0.01
Cash flow prior to working capital changes ¹	1,718	3,491	3,224
	Year Ended March 31, 2011	Six Months Ended March 31, 2010	Year Ended September 30, 2009
Working capital ¹	\$ 12,762	\$ 17,503	\$ 15,135
Total assets	35,439	44,077	37,887
Total long-term debt and obligations under capital lease (including current portion)	843	6,027	6,359
Shareholders' equity	24,794	25,795	23,060

¹ These financial measures are identified and defined under the section “Non-GAAP Financial Measures”.

OVERALL PERFORMANCE

Revenue during the year ended March 31, 2011 was \$39.6 million. This compares to revenue of \$56.1 million generated during the same twelve-month period ended March 31, 2010 and revenue of \$47.6 million reported in the year ended September 30, 2009.

Revenue from our lead product, COLD-FX, is highly dependent on the frequency and severity of colds and flu experienced in Canada. We believe revenue during the twelve-month period ended March 31, 2010 was high as retailers commenced purchasing large quantities of cold and flu products due to public concern over the presence of H1N1, a pandemic strain of the flu. In contrast, we believe revenue during the year ended March 31, 2011 was low as retailers entered fiscal 2011 well stocked with COLD-FX product. Retailers were well stocked by December 2009, but consumer demand for all cold and flu products

decreased in the January to March 2010 winter months as concerns over the pandemic outbreak of the flu lessened dramatically and incidence of other strains of the flu did not significantly emerge, as is normal during this period. Retailers placed fewer re-stocking orders in fiscal 2011 than what we normally experience in order to reduce their end-of-season cold and flu product inventories to a level more in line with their expectations.

Moving into fiscal 2012, we believe revenue will improve over last year's results. First, we believe retailer and consumer inventory levels of COLD-FX have normalized and therefore, we expect revenue from COLD-FX to be more comparable to the revenue we reported during the year ended September 30, 2009, a period when sales were not as significantly impacted by the pandemic outbreak of the flu. We will also be launching a new product called COLDSORE-FX this coming fiscal year, which will add to our expected revenue growth (see "Advisory Regarding Forward-looking Statements").

Despite lower revenue achieved during the year, we were able to increase our gross margin to 72.0% for the year ended March 31, 2011. This compares to gross margins of 68.4% and 67.6%, respectively, for the six-month period ended March 31, 2010 and year ended September 30, 2009. During fiscal 2011, we continued to improve our inventory management and purchasing practices to achieve lower production costs and reduce obsolescence-related inventory write-downs. We are targeting to continue to achieve annual gross margins in excess of 70% in the future (see "Advisory Regarding Forward-looking Statements").

Despite having moderately higher revenue of \$39.6 million in the twelve-month fiscal year ended March 31, 2011 as compared to \$34.4 million in the six-month fiscal year ended March 31, 2010, net earnings decreased to a loss of \$0.8 million or \$0.01 per share as compared to net earnings of \$2.8 million or \$0.03 per share, respectively. This is primarily due to twelve months of expenses being incurred in the current fiscal year versus six months of expenses being incurred in the previous fiscal year-end.

COLD-FX continues to be the number one pharmacist and doctor recommended natural cold remedy as reported by Drugstore Canada's and L'actualité Pharmaceutique's 2009 / 2010 Survey on OTC Counseling and Recommendations and The Medical Post's 2009 / 2010 Survey on OTC Counseling and Recommendations, respectively. In addition, COLD-FX remains the number one selling cold and flu remedy in Canada for the 52-week period ended March 12, 2011, per Point of Sale Data received from the Nielsen Company.

VISION AND STRATEGY

Our vision is to deliver the most trusted health brand on the planet. We plan to achieve our vision by pioneering evidence-based natural medicines that empower people to achieve their health potential. However, to achieve this vision, we must grow. This means growing our product offering to consumers and expanding our geographic presence.

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

EXECUTING OUR GROWTH STRATEGIES – PRODUCT DIVERSIFICATION

We continue to invest in scientific and clinical research to identify and develop new and effective natural medicines. Through a strong scientific research and development team, we are expanding our product offering through the following initiatives:

- Developing existing product candidates beyond COLD-FX;
- Advancing multiple product candidates through clinical trials and targeted development;
- Increasing discovery research and development on new product candidates; and
- In-licensing third-party products that align with our vision.

COLDSORE-FX

In October 2010, we signed an exclusive in-license agreement with Lisoma International Ltd. and Lisoma Canada Ltd. (collectively "Lisoma") whereby we were granted the exclusive Canadian rights to use, market, sell and distribute Lisoma's proprietary natural health product for the treatment of cold sores.

The product, which we have branded COLDSORE-FX, was recently granted a Natural Product Number (“NPN”) from Health Canada’s Natural Health Products Directorate, allowing the product to be sold in Canada as an over-the-counter remedy to relieve the pain of cold sores and to speed healing time. COLDSORE-FX has been clinically proven to shorten the healing time and relieve the pain associated with cold sores.

We are currently finalizing our sales and marketing programs to launch this product into the Canadian marketplace with shipments to retail customers expected to commence in the summer of 2011. 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 continue to investigate new in-licensing opportunities for natural health products that align with our vision – products that are proprietary, effective, safe, and supported by high quality clinical trials.

IMMUNITY-FX®

In the fall of 2009, we launched a new product, IMMUNITY-FX. IMMUNITY-FX is designed as a daily immune booster to help consumers stay healthy and is comprised of a special formulation to help the immune system fight germs and pathogens that are foreign to the body. We are conducting a number of public relations, social media and marketing events to continue to broaden consumer awareness of IMMUNITY-FX.

CHOLESTEROL MANAGEMENT

Using our ChemBioPrint technology, we have discovered a prototype product designed to manage cholesterol levels. Pre-clinical studies of this proprietary formulation have shown that it has the potential to manage abnormal cholesterol. A pilot clinical trial examining safety and effect size has recently been completed and data analysis is in progress. Preliminary data signals demonstrate similar efficacy to our pre-clinical studies. Further clinical and formulation development is in the planning stages. (See “Advisory Regarding Forward-looking Statements”.)

COLD-FX PEDIATRICS

A multi-centre clinical trial exploring the potential application of COLD-FX in a pediatric population is in progress. The randomized, double-blind, placebo-controlled trial led by Dr. Shelly McNeil of the Canadian Center for Vaccinology, is rare in the field and is designed to assess the potential benefit of COLD-FX in reducing cold and flu symptoms and the burden of disease on children. Volunteers are taking a special formulation of COLD-FX for children or a placebo at the first onset of symptoms. A total of 500 children 3–11 years of age from Halifax, Edmonton, Toronto, and Saint John are being recruited for the study, with an estimated 300 children developing an infection and entering the trial. The study is a follow-up to a positive randomized controlled trial demonstrating the safety of COLD-FX in this population and providing early indications of efficacy, which was used in designing the current study. This clinical trial will continue into the next cold and flu season.

SEASONAL ALLERGIC RHINITIS

Positive pre-clinical lab studies examining the potential of CVT-E002, the core active ingredient in COLD-FX and IMMUNITY-FX, in asthma and allergy-related indications have been completed. Data analysis is currently in progress for a recently completed randomized, placebo-controlled, double-blind clinical trial involving 200 participants with seasonal allergic rhinitis.

CANCER – CHRONIC LYMPHOCYTIC LEUKEMIA

A National Cancer Institute supported and Wake Forest Baptist Medical Centre led multi-centre clinical trial involving 293 patients with chronic lymphocytic leukemia demonstrated that patients taking CVT-E002 showed a statistically significant reduction in the incidence of moderate to severe acute respiratory infection (ARI) symptoms and a trend of reduced incidence of moderate to severe ARI. There was no significant difference shown for patients with mild ARI symptoms, average number of ARI days or antibiotic use. In addition, greater seroconversion (antibody levels) was observed against nine common upper respiratory viral pathogens with CVT-E002 versus placebo. This is thought to reflect a CVT-E002 induced increase in antibody response and may be important since CLL patients generally have impaired antibody responses and immune suppression. The outcome demonstrates the potential of CVT-E002 to help reduce the incidence, duration, and severity of ARI and corresponding symptoms in CLL and possibly in other cancers. Afexa is in the planning stages for a clinical trial exploring higher dosage levels.

BRAIN HEALTH

We are continuing to investigate the core active ingredient in REMEMBER-FX® and MEMORY-FX®, HT1001™, in healthy aging adults. In previous clinical trials, HT1001 intake was associated with improvements in memory in generally healthy adults and schizophrenia patients, and reduced oxidative stress which is associated with many diseases, including neurodegeneration. We are now planning an additional clinical trial for oxidative stress and brain function.

OTHER RESEARCH AND DEVELOPMENT

Our research has discovered potential polymolecular botanical toll-like receptor (“TLR”) modulators. These are a class of molecules that can specifically target multiple physiological and therapeutic sites, and have the potential to prevent and fight a variety of diseases including cancer and some chronic viral infections. We are now evaluating the opportunities for advancing the development of these potential therapeutics.

We have also discovered a potential polymolecular formulation that has shown synergistic effects on increasing glucose uptake in cultured skeletal muscle cells, indicating therapeutic potential in diabetes prevention and management. This formulation is now ready for testing in a pilot open-label dose-ranging clinical trial exploring safety and efficacy.

EXECUTING OUR GROWTH STRATEGIES – MARKET DIVERSIFICATION

Canada remains the engine of our business and the primary showcase for our products. However, we are advancing several initiatives to expand our market penetration both within Canada and internationally.

CANADA

Despite the strong success of our lead product, COLD-FX, its household penetration generally across Canada is still small. We continue to invest in marketing initiatives and public relations programs to increase the exposure of COLD-FX in Canada.

In addition, consumer surveys show that COLD-FX is underdeveloped in the Province of Quebec relative to other provinces in Canada. We have increased our pharmacist and doctor education programs in this province and have designed specific marketing programs for the Quebec consumer. Due to the unique nature of this market and the way pharmacy stores are owned and operated in Quebec, we have also engaged sales personnel specifically dedicated to developing our market in this province. These dedicated personnel are directly visiting retailers and pharmacists in the Quebec market. Over the past two years, we have achieved significant revenue growth in this geographic location.

In fiscal 2012, we plan to expand this direct sales retail model to include the Province of Ontario. We believe this model will help strengthen our merchandising capabilities and pharmacy education programs to accelerate our revenue growth in this province (see “Advisory Regarding Forward-looking Statements”).

UNITED STATES

We believe that certain Afexa products potentially fit the criteria for development under a relatively new “Botanical Drug” category defined by the United States Food and Drug Administration (“FDA”). Market approval as a Botanical Drug follows the same process as for non-botanical drugs, with the important difference that unique FDA expertise in botanical medicine is involved in the regulatory review process. Approval of a New Drug Application (“NDA”) is based on pre-clinical and toxicology data, adequate information on chemistry manufacturing and controls, and previous human experience. The latter includes clinical trials, which may be conducted after the approval of an Investigational New Drug (“IND”) application. The eventual approval of the NDA by the FDA will permit the marketing of a polymolecular-based botanical product as a drug.

While this is potentially a faster route to approval and commercialization than the traditional drug pathway, it is still a multi-year process. We are considering seeking botanical drug approval in the United States. This may allow us to make expanded therapeutic health claims in the United States and better position ourselves in this large cold, flu, and immunotherapy-related pharmaceutical market (see “Advisory Regarding Forward-looking Statements”).

OVERSEAS

We continue to meet with regulatory experts and companies in geographic locations outside Canada and the United States to better understand how to sell our products internationally. For example, we are currently assessing business opportunities and have commenced the regulatory approval process in China. In Hong Kong, we have established a distributor agreement with a local company and are now selling small amounts of COLD-FX into that market.

OTHER GROWTH STRATEGIES

Our strategic plan also contemplates other potential growth initiatives, such as business acquisitions, strategic partnerships, and international licensing arrangements.

RESULTS OF OPERATIONS FOR THE YEAR ENDED MARCH 31, 2011

REVENUE

Revenue and Gross Profit Summary

<i>(in thousands)</i>	Year Ended March 31, 2011	Six Months Ended March 31, 2010	Year Ended September 30, 2009
Revenue	\$ 39,596	\$ 34,374	\$ 47,592
Cost of goods sold	11,091	10,866	15,440
Gross profit	28,505	23,508	32,152
Gross margin %	72.0%	68.4%	67.6%

Revenue during the year ended March 31, 2011 was \$39.6 million. This compares to revenue of \$56.1 million generated during the same twelve-month period ended March 31, 2010 and revenue of \$47.6 million reported in the year ended September 30, 2009. 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.

As mentioned earlier in this MD&A, we believe revenue during the twelve-month period ended March 31, 2010 was high as retailers commenced purchasing large quantities of cold and flu products due to public concern over the presence of H1N1. In contrast, we believe revenue during the year ended March 31, 2011 was low as retailers entered fiscal 2011 well stocked with COLD-FX product. Retailers placed fewer re-stocking orders in fiscal 2011 than what we normally experience in order to reduce their end of season cold and flu product inventories to a level more in line with their expectations.

Revenue during the six-month transitional year ended March 31, 2010 was \$34.4 million. Despite being only six months in length, revenue was relatively high in this period as it included the time frame when public concern over H1N1 was at its peak. The first quarter of this six-month period ended March 31, 2010, corresponded to a period with the greatest reported H1N1 cases in Canada and the quarter that had the highest reported revenue of \$29.5 million in our history.

GROSS MARGIN

Despite lower revenue, we increased our gross margin to 72.0% during the year ended March 31, 2011. This compares to gross margins of 68.4% and 67.6%, in the six-month period ended March 31, 2010 and year ended September 30, 2009, respectively. During fiscal 2011, we improved a number of our inventory management and purchasing practices to achieve lower production costs and reduce obsolescence-related inventory write-downs. Included in cost of goods sold in fiscal 2011 were write-downs of inventory of \$0.5 million, which compares quite favorably to write-downs of \$1.0 million and \$1.7 million, respectively, incurred during the six-month period ended March 31, 2010 and year ended September 30, 2009.

Moving into fiscal 2012, we are continuing to execute a number of initiatives to further improve our inventory management and purchasing practices. These initiatives include lower pricing from our Canadian suppliers due to new contracts and strategic regional buying; improved production planning to minimize inventory write-downs; and achieving economies of scale from fixed production overhead expenses through higher sales volumes. Through these initiatives, we expect to continue to achieve annual gross margins in excess of 70% in the future (see "Advisory Regarding Forward-looking Statements").

SALES AND MARKETING

Sales and marketing expenses increased to \$13.0 million during the year ended March 31, 2011 from \$11.3 million in the six-month period ended March 31, 2010 and \$12.8 million in the year ended September 30, 2009.

Many of our marketing program expenditures typically follow a seasonal pattern tied to sales of COLD-FX. As a result, we incur significantly higher marketing expenses during the quarters ended December 31 and March 31 of each year compared to the other quarters of the year. Although the comparative period ended March 31, 2010 was only six months in duration, sales and marketing expenses were only moderately lower than the twelve-month periods ended March 31, 2011 and September 30, 2009 because of this seasonal trend. In addition, during the six months ended March 31, 2010 we incurred additional expenditures in connection with our sponsorship of the 2010 Olympic Winter Games.

Also contributing to lower expenses during the year ended March 31, 2011 (on a relative basis to the six-month transitional year ended March 31, 2010) was a reduction in discretionary marketing expenditures to better align our marketing expenses with expected revenue results for the year.

Compared to the year ended September 30, 2009, sales and marketing expenses increased by \$0.1 million during the year ended March 31, 2011. Over the past year-and-a-half, we have been expanding our sales and marketing resources to further our presence in the Canadian marketplace and to prepare for the launch of new product candidates, including COLDSORE-FX. To further enhance our skill-sets and manage succession in this area, we have also recently hired a person in the role of Chief Marketing Officer and Senior Vice President Sales.

GENERAL AND ADMINISTRATION

General and administration ("G&A") expense was \$9.2 million in the year ended March 31, 2011 compared to \$4.5 million during the six-month transitional year ended March 31, 2010. This increase is mainly due to fiscal 2010 being only a six-month period in duration whereas fiscal 2011 included a full twelve-month period of expense.

Compared to G&A of \$11.1 million incurred in the year ended September 30, 2009, G&A expense declined by \$1.9 million in fiscal 2011. Contributing to this decline were costs totalling \$1.1 million in fiscal 2009 related to legal, professional and settlement costs associated with an agreement reached with the Alberta Securities Commission. These costs did not reoccur in the year ended March 31, 2011. Additional G&A expenses were also incurred in fiscal 2009 related to one-time severance and recruiting costs related to the Company's restructuring during that period.

RESEARCH AND DEVELOPMENT

Research and development ("R&D") costs increased to \$4.9 million during the year ended March 31, 2011 from \$2.2 million in the six-month period ended March 31, 2010 and \$3.4 million in the year ended September 30, 2009. This increase in fiscal 2011 is attributable to our growing investment in research and development activities to move forward our pipeline of new product candidates and advance our international expansion opportunities.

Offsetting R&D costs in fiscal 2011 were \$1.2 million (six months ended March 31, 2010 – \$0.2 million and year ended September 30, 2009 – \$0.5 million) of scientific research and development ("SRED") tax credits. The higher SRED tax credits recognized in fiscal 2011 is in part due to our increased investment in R&D, as discussed above. In addition, in fiscal 2011, we also received audit confirmation on certain SRED credit balances owing to the Company and then revised our estimates of the total amount of SRED tax credits realizable to us from fiscal years 2008 to present.

We continue to fund all of our research and development activities from internal cash flow generated from operating activities in addition to funds received from SRED tax credits and grants.

STOCK-BASED COMPENSATION

We recognized stock-based compensation expense of \$0.8 million during the year ended March 31, 2011, which reflects an increase of \$0.5 million from the six-month period ended March 31, 2010. The increase from fiscal 2010 is largely due to the comparative period being only six months in duration versus a full twelve-month period in fiscal 2011. In addition, we also incurred additional stock-based compensation expense in fiscal 2011 due to Company-wide stock option grants in March 2010 and February 2011.

Stock-based compensation in fiscal 2011 was comparable to the \$0.8 million expense also recognized in the year ended September 30, 2009.

EBITDA

For the year ended March 31, 2011, we generated EBITDA (see "Non-GAAP Financial Measures") of \$0.4 million compared to EBITDA of \$5.2 million reported in the six months ended March 31, 2010 and \$3.8 million reported in the year ended September 30, 2009. Lower revenue in fiscal 2011 and higher expenses in research and development caused the majority of this decline.

INTEREST AND BANK CHARGES

Interest and bank charges increased to \$0.3 million during the year ended March 31, 2011 from \$0.2 million in the comparative six-month period ended March 31, 2010. This increase is directly attributable to fiscal 2010 being only six months in duration compared to a full twelve-month period in fiscal 2011.

When compared to the year ended September 30, 2009, interest and bank charges in fiscal 2011 declined by \$0.1 million. During the year, we paid out our long-term mortgage of \$5.0 million in September 2010. As at March 31, 2011, with the exception of an obligation under capital lease of \$0.8 million, we were debt-free.

AMORTIZATION

We incurred amortization expense of \$1.4 million, \$0.7 million and \$1.3 million, respectively, during the year ended March 31, 2011, six months ended March 31, 2010 and year ended September 30, 2009. Once amortization expense for the six months ended March 31, 2010 is annualized to a full twelve-month basis, amortization expense in each of the periods presented is comparable. Additional amortization incurred on new equipment and intangible assets, which we have purchased over the past two years, has been offset by older assets becoming fully amortized.

INCOME TAXES

In fiscal 2011, we recognized an income tax recovery of \$0.4 million, representing an effective income tax rate of 31.5% on a loss before income taxes of \$1.2 million. This compares to income tax expense of \$1.5 million reported during the six months ended March 31, 2010, representing an effective income tax rate of 35.3% on earnings before income taxes of \$4.3 million. We experienced a lower effective tax rate in fiscal 2011 due to non-deductible expenses in relation to the net loss incurred in the current fiscal year as compared to the magnitude of the net income in the prior fiscal year. In periods when we incur a loss before income taxes, non-deductible expenses reduce the amount of income tax that would otherwise be recoverable to the Company. Our largest non-deductible expense is stock-based compensation expense related to stock options.

In fiscal 2009, we incurred income tax expense of \$0.9 million, reflecting an effective income tax rate of 42.0% on earnings before income taxes of \$2.2 million. The higher effective tax rate in fiscal 2009 was due to non-deductible amounts and an increase in valuation allowances.

NET EARNINGS

We reported a net loss of \$0.8 million during the year ended March 31, 2011 compared to net earnings of \$2.8 million reported in the six months ended March 31, 2010 and net earnings of \$1.3 million during the year ended September 30, 2009. The net loss in fiscal 2011 was caused primarily from lower revenue and gross profit as well as planned higher expenditures in R&D relative to the comparative periods.

RESULTS OF OPERATIONS FOR THE FOURTH QUARTER ENDED MARCH 31, 2011

Revenue and Gross Profit Summary

<i>(in thousands)</i>	Three Months Ended March 31	
	2011	2010
Revenue	\$ 6,021	\$ 4,827
Cost of goods sold	1,912	2,751
Gross profit	4,109	2,076
Gross margin %	68.2%	43.0%

Revenue

Revenue in both the quarters ended March 31, 2011 and March 31, 2010 was modest due to the seasonality that is inherent in sales of COLD-FX. Our quarter ended March 31 corresponds to the time that the incidence of colds and flu are on the decline and retailers are reducing their inventory positions as the end of the cold and flu season approaches.

Revenue increased by \$1.2 million to \$6.0 million during the quarter ended March 31, 2011 from revenue of \$4.8 million reported in the same quarter last year. The year-over-year improvement was due to lower spending on discounts and allowances with retail customers. In addition, we believe revenue also increased due to higher incidence of colds and flu within the Canadian population in this quarter compared to the same quarter in the prior year.

GROSS MARGIN

During the three months ended March 31, 2011, gross margin improved to 68.2% from 43.0% in the same quarter last year. Several factors contributed to this improvement, which included lower inventory write-downs, a reduction in estimated customer product returns, lower spending on trade investment initiatives with retail customers and overall improvements in inventory management practices as discussed earlier in this MD&A. Specifically, during the fourth quarter ended March 31, 2011, we reversed inventory write-downs of \$15 thousand compared to inventory write-downs of \$877 thousand recognized in the comparative quarter ended March 31, 2010.

Gross margin in the quarter ended March 31, 2011 was slightly lower than our gross margin of 72.0% reported for the full year ended March 31, 2011. Our costs of goods sold include both variable components that fluctuate with revenue as well as fixed costs that remain relatively constant from period to period. In addition, certain customer discounts and allowances (recognized as a deduction in reported revenue) are also fixed in nature and therefore, reduce our gross margin in periods of lower sales.

SALES AND MARKETING

Sales and marketing expenses declined by \$1.3 million to \$3.2 million during the quarter ended March 31, 2011 from the same three-month period in the prior year. During the quarter ended March 31, 2010, we incurred additional expenditures in connection with our sponsorship of the 2010 Olympic Winter Games that did not reoccur this year. Also contributing to lower expenses during the quarter were reductions in planned marketing program expenditures in the second half of fiscal 2011 to better align our marketing expenses with expected revenue results for the year.

GENERAL AND ADMINISTRATION

General and administration expense increased by \$0.8 million to \$2.5 million during the fourth quarter of fiscal 2011 from \$1.8 million reported in the same period of the previous year. Contributing to the increase were additional investments in corporate development activities and new management personnel over the past twelve months to further our business development and growth strategies. In addition, we reported a negative adjustment to variable short-term incentive expense in the comparative quarter ended March 31, 2010, which further contributed to the increase in 2011. No variable short-term incentive expense was recognized during the current quarter ended March 31, 2011, as we did not meet our internal revenue and EBITDA targets for this period.

RESEARCH AND DEVELOPMENT

R&D costs increased to \$1.6 million during the quarter ended March 31, 2011 from \$0.7 million in the same quarter of the previous year. During the quarter, we expended additional funds advancing clinical trials and research projects, which were not incurred to the same degree in the comparative quarter ended March 31, 2010. Offsetting R&D costs for the quarter were \$0.2 million (three months ended March 31, 2010 – \$0.1 million) of scientific research and development tax credits.

OTHER EXPENSES

We recognized stock-based compensation expense of \$0.2 million during the three months ended March 31, 2011, which was comparable to the \$0.2 million expense recognized in the same three-month period of 2010. Amortization of \$0.3 million reported in the quarter ended March 31, 2011 also approximated amortization recognized in the comparative period ended March 31, 2010.

INCOME TAXES

During the quarter, we recognized an income tax recovery of \$1.2 million, representing an effective income tax rate of 29.4% on a loss before income taxes of \$4.0 million. This compares to an income tax recovery of \$1.5 million recognized in the comparative quarter ended March 31, 2010, reflecting an effective tax rate of 27.3% on a loss before income taxes of \$5.5 million. The higher effective tax rate in the quarter ended March 31, 2011 is largely due to favourable income tax rate adjustments that were applicable to our carry-back of non-capital losses incurred in the quarter to previous fiscal years.

NET LOSS

We incurred a net loss of \$2.8 million in the fourth quarter of fiscal 2011, which reflects an improvement of \$1.2 million from the net loss of \$4.0 million reported in the comparative quarter ended March 31, 2010. Higher revenue and gross margin reported in the current quarter caused this improvement.

Quarterly Information

	For Quarters Ended							
<i>(in thousands except for per share amounts)</i>	March 31 2011	December 31 2010	September 30 2010	June 30 2010	March 31 2010	December 31 2009	September 30 2009	June 30 2009
Revenue	\$ 6,021	\$ 12,628	\$ 19,189	\$ 1,758	\$ 4,827	\$ 29,547	\$ 15,557	\$ 6,195
Net (loss) earnings	(2,811)	934	5,124	(4,075)	(4,027)	6,816	2,782	(1,120)
(Loss) earnings per common share – basic and diluted	(0.03)	0.01	0.05	(0.04)	(0.04)	0.06	0.03	(0.01)

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, starting in the quarter ended June 30, 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 the quarters ended June 30, 2009, September 30, 2009 and December 31, 2009 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 cold and flu was lower than in the same quarter last year. In the quarter ended March 31, 2011, revenue declined from the prior quarters ended September 30, 2010 and December 31, 2010 as the end of the cold and flu season approached and retailers managed down their product inventory levels.

LIQUIDITY AND CAPITAL RESOURCES

Our main source of capital during the year ended March 31, 2011 was our cash on hand provided from operating activities in prior periods. The primary use of our cash during the year was to fund working capital needs and pay out our mortgage in September 2010.

Our working capital and capital expenditure requirements depend upon numerous other 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>	Twelve Months Ended March 31, 2011	Six Months Ended March 31, 2010	Twelve Months Ended September 30, 2009
Cash flow prior to working capital changes ¹	\$ 1,718	\$ 3,491	\$ 3,224
Cash (used in) provided by operating activities	(7,269)	15,871	(2,676)
	As at March 31, 2011	As at March 31, 2010	As at September 30, 2009
Cash	\$ 3,691	\$ 17,685	\$ 3,495
Working capital ¹	12,762	17,503	15,135
Long-term debt and obligations under capital lease (including current portion)	843	6,027	6,359

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

CASH AND WORKING CAPITAL

At March 31, 2011, we had \$3.7 million of cash on hand. This compares to \$17.7 million in cash at March 31, 2010. During the year ended March 31, 2011, we utilized cash on hand to fund our working capital needs, complete capital expenditures, and repay our outstanding mortgage.

Our working capital position at March 31, 2011 was \$12.8 million (March 31, 2010 – \$17.5 million). The decrease of \$4.7 million from March 31, 2010 is primarily due to paying out our long-term mortgage in September 2010.

CASH USED IN OPERATING ACTIVITIES

Cash flow prior to working capital changes was \$1.7 million during the year ended March 31, 2011 compared with \$3.5 million in the six-month period ended March 31, 2010 and \$3.2 million in the year ended September 30, 2009. Lower earnings during the year ended March 31, 2011 caused this decline. Including changes in working capital items, we utilized \$7.3 million in cash from operating activities during the year ended March 31, 2011 as we used cash on hand to build inventory levels, pay required income tax instalments and reduce accounts payable and accruals.

CASH USED IN INVESTING ACTIVITIES

Capital expenditures for the year ended March 31, 2011 included purchases of property and equipment of \$0.3 million and additions to intangible assets of \$0.5 million. These expenditures were incurred primarily for lab and computer equipment as well as for patent and trademark costs associated with new product development. Offsetting additions to property and equipment in fiscal 2011 were SRED tax credits of \$0.2 million related to capital expenditures.

CASH USED IN FINANCING ACTIVITIES

During the year ended March 31, 2011, we repaid our mortgage in full and repurchased common shares under our NCIB resulting in net cash used in financing activities of \$5.9 million.

NORMAL COURSE ISSUER BID

On October 14, 2009, we received approval from the Toronto Stock Exchange ("TSX") to renew our normal course issuer bid ("NCIB") to repurchase common shares from the market. Effective October 18, 2010, we again renewed our NCIB with the 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 year ended March 31, 2011, we repurchased and cancelled 1,309,618 common shares pursuant to the NCIB at a total cost of \$0.7 million or \$0.53 per common share.

AGGREGATE CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET FINANCING

We enter into operating and capital leases and purchasing agreements in the ordinary course of our business. In addition, we have entered into various agreements to provide financial assistance in research and development activities and clinical studies. Payment commitments relating to these agreements and under our obligation under capital lease over the next five years and thereafter, are as follows:

Contractual Obligations

(in thousands)	Fiscal Year Ended March 31						
	2012	2013	2014	2015	2016	Thereafter	Total
Obligations under capital lease	\$ –	\$ –	\$ –	\$ –	\$ 1,155	\$ –	\$ 1,155
Leased premises	185	175	175	177	179	775	1,666
Operating lease payments sponsorships and other ¹	1,413	144	0	–	–	–	1,557
	\$ 1,598	\$ 319	\$ 175	\$ 177	\$ 1,334	\$ 775	\$ 4,378

¹ The Company has entered into a number of office equipment leases and contractual obligations related to future advertising, marketing, research and development, clinical and material expenditures.

In addition to the contractual obligations noted in the above table, 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 a minimum of \$3.0 million of inventory from this CMO over a three-year period. As at March 31, 2011, the remaining commitment to this CMO was \$2.9 million. On March 24, 2011, we also entered into an agreement with another CMO to develop a new product. If we proceed in launching this product, the contractual terms provide for a commitment of \$1.2 million.

During the year ended March 31, 2011, we paid out the remaining mortgage on our Edmonton facility. We also entered into a credit facility agreement with a new bank that consists of 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 Afexa is based on: (i) 65% of the Edmonton, Alberta head office and research centre's appraised value to a maximum limit of \$6.8 million (maximum limit to be reduced annually based on an amortization period of 15 years), (ii) 75% of accounts receivable aged less than 90 days,

and (iii) 50% of finished goods inventory to a maximum limit of \$4.1 million. The credit facility is collateralized by a General Security Agreement constituting a first ranking security interest in all personal property of the Company and a demand collateral mortgage constituting a first fixed charge on our head office and research facility. The credit facility is currently undrawn.

We also have an obligation under capital lease related to land on which our Edmonton, Alberta head office and research facility is located. The capital 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").

We project that capital expenditures for the year ending March 31, 2012 will be between \$1.0 million and \$1.4 million, which will primarily consist of lab, office, and computer equipment as well as patent and trademark costs associated with new product development (see "Advisory Regarding Forward-looking Statements").

RELATED PARTY TRANSACTIONS

Included in general and administration expenses during the year ended March 31, 2011, were management and consulting fees of \$32 thousand (six months ended March 31, 2010 and twelve months ended September 30, 2009 – \$nil) incurred from a company controlled by a director of Afexa.

Until October 2008, our management team included an individual who was also related to the principal owners of a vendor. During the year ended September 30, 2009, we incurred \$56 thousand within sales and marketing expenses during the period in which the related party relationship existed.

All transactions with related parties occurred in the normal course of operations and were measured at the exchange amount, which was the amount of consideration established and agreed to by the related parties.

OUTSTANDING SHARES AND STOCK OPTIONS

We are authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at June 9, 2011, 103,202,552 common shares were outstanding (March 31, 2011 – 103,202,552 and March 31, 2010 – 104,504,670). No preferred shares were outstanding during or at the end of these periods. Certain of our employees, officers, contractors and directors were granted options to purchase common shares under our stock option plan. At June 9, 2011, 7,105,914 options were outstanding (March 31, 2011 – 7,105,914 and March 31, 2010 – 5,658,684).

OUTLOOK

Moving into fiscal 2012, we believe revenue will improve over last year's results. First, we believe retailer and consumer inventory levels of COLD-FX have normalized and therefore, we expect revenue from COLD-FX to be more comparable to the revenue we reported during the year ended September 30, 2009, a period that sales were not as significantly impacted by the pandemic outbreak of the flu. We will also be launching a new product called COLDSORE-FX this coming fiscal year, which will add to our expected revenue growth (see "Advisory Regarding Forward-looking Statements").

By the end of the next five years, our strategic plan is designed to deliver to our shareholders average annual revenue growth in excess of 10% (see "Advisory Regarding Forward-looking Statements"). Our growth strategies are well underway to achieving this goal. We are in clinical trials for a pediatric version of COLD-FX and have commenced or are in product development and clinical trial stages for lipid and glucose, antioxidant, and allergy products. Additional R&D activity is ongoing in product formulation, delivery systems and manufacturing processes, and commercial scale-up.

Please see discussions under "Executing our Growth Strategies – Product Diversification" and "Executing our Growth Strategies – Market Diversification" earlier in this MD&A for further details surrounding these growth initiatives.

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

In accordance with National Instrument 52-109, we are responsible for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting.

DC&P are developed and implemented to provide reasonable assurance that material financial and non-financial management information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the securities legislation, and that it is communicated to the Chief Executive Officer, Chief Financial Officer and Disclosure Committee to allow for timely decisions regarding required disclosure. The system of disclosure controls and procedures includes, but is not limited to, the Company’s Public Disclosure Policy, Core Values and Code of Conduct, Whistle Blower Policy, the effective functioning of the Disclosure Committee, and the review and verification of material disclosures by senior management, the Board of Directors and committees of the Board.

We are also responsible for the establishment and maintenance of ICFR which provide reasonable assurance regarding the reliability of public financial reporting that reflect our transactions and dispositions; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP; ensure that receipts and expenditures are made only in accordance with authorizations of management; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on financial statements.

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.

We completed an evaluation of the effectiveness of our DC&P and ICFR as at March 31, 2011 under the supervision of the Chief Executive Officer and the Chief Financial Officer. The evaluation included a documentation review, enquiries and observation of process and control performance.

Throughout the year ended March 31, 2011 we have completed redesign and implementation of our financial estimation processes (including those processes and controls related to accrued liabilities and estimation of the value of trade promotions), and our information technology processes (relating to logical access and change management).

We have concluded that DC&P and ICFR are effective in providing management with material information relating to the Company in a timely manner, to a reasonable standard of assurance.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Other than the remediation activity described above, there have been no material changes in ICFR.

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 resource constraints, and the benefits of controls must be considered relative to their costs. We will continue to monitor and improve internal controls as necessary and appropriate for the business.

RISKS AND UNCERTAINTIES

Our business is subject to certain risks and uncertainties related to financial risks (including liquidity, interest rate, and credit 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. Prior to making any investment decision regarding Afexa, investors should carefully consider, among other things, the risks described within this MD&A. Further discussion regarding these and other risks can also be found in our Annual Information Form filed on the SEDAR website at www.sedar.com. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business and operations.

MARKET AND PRODUCT

We believe our Company is in the growth stage with our lead product, COLD-FX. To achieve a successful market share, we anticipate significant and ongoing expenditures for marketing, advertising and public awareness programs. We also plan to introduce new products to the market and significant expenditures for marketing, advertising and public relations programs will be required to launch these products. Future success of product revenue is dependent on those activities as well as the successful results of clinical trials, regulatory review and approval for our products, and the degree of patent protection afforded to particular products.

We are reliant on relatively few customers for the majority of our revenue. A loss of one of these customers could adversely affect revenues and business operations. During the year ended March 31, 2011, four Canadian customers accounted for 75% of our consolidated revenue. During the six months ended March 31, 2010, three customers accounted for 59% of our consolidated revenue and for the year ended September 30, 2009, four customers accounted for 76% of our consolidated revenue.

SEASONALITY OF DEMAND

COLD-FX sales 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. We aim to time marketing expenditures with increases in cold and flu activity, and as such, expenditures and results may vary.

RISKS ASSOCIATED WITH NEW PRODUCT DEVELOPMENT

One of our core competencies is in the area of research and development of new natural health products. A number of products are under development. Considerable costs are incurred at every stage of identifying, developing, manufacturing and marketing new products.

There can be no assurance during any given research or development stage that any viable new products will be developed for which sufficient market demand exists. The costs of conducting basic and clinical research to identify potential new product opportunities can be significant. There can also be no assurance during any development stage that any new products developed will receive regulatory approval to make the marketing claims necessary to make the product commercially viable. Some of these products will compete with established products of proven safety and efficacy, the manufacturers of which may employ intellectual property challenges against our commercialization of the products. There can be no assurance that our products will be commercialized or, if commercialized, that consumers will accept them in lieu of established products. Accordingly, there can be no assurance that these products can be manufactured successfully and/or marketed profitably. Prospects for our new technologies and future products are uncertain and should be regarded as highly speculative.

Expectations about our scientific results could have a significant effect on the trading price of our common shares. Certain risks exist in the timing of scientific and regulatory reviews, filings and approvals, and our ability to commercialize products in our pipeline.

HEALTH AND SAFETY RISKS

We produce products for human ingestion. Products produced may be found to contain substances that are harmful to the health of our customers, which in extreme cases may cause serious health conditions or death. This sort of finding may expose us to substantial risk of litigation and liability. Further, we could be forced to discontinue production of certain products, which would harm our profitability. To mitigate this risk we take substantial precautions such as laboratory and clinical testing, toxicology studies, quality control and assurance testing and controlled production methods. We also maintain product liability insurance coverage; however, there is no guarantee that coverage can be secured in the future at commercially viable rates or with the appropriate limits.

RISKS ASSOCIATED WITH RAW MATERIAL SUPPLY

We are dependent on the availability of raw materials derived from natural resources. The supply of ginseng, chondroitin sulphate and other natural materials we use may be limited, lost or affected by events such as changes in weather patterns and growing seasons, disease and pathogens to which the natural resources are vulnerable, natural or man-made disasters and environmental regulations. There can be no assurance that these or other factors will not affect the supply of materials. We maintain relationships with a number of raw material suppliers to mitigate this risk.

RELIANCE ON THIRD PARTIES

We rely on contract manufacturing organizations for extraction, encapsulation, packaging and warehousing of our products. Dependence upon third parties for the manufacturing of our products may affect our earnings and ability to make and deliver such products on a timely and competitive basis. Deficiencies could result from, among other things, the disruption of product supply. Some contract manufacturing organizations are located in foreign countries and may be subject to import and export regulations in these countries. To mitigate this risk, we create collaborative arrangements and alliances, and establish alternate supply arrangements.

LIQUIDITY RISK

Our exposure to liquidity risk is dependent on the sale of inventory, collection of accounts receivable, purchasing commitments and obligations or raising of funds to meet commitments and sustain operations. Our liquidity objective is to maintain the capacity to fund assets and repay liabilities in a timely and cost-effective manner under adverse market conditions and unforeseen events. This capacity primarily derives from our earnings and ability to issue debt and equity instruments as well as our ability to generate liquidity from our balance sheet (convert assets, for example inventory, to cash).

Our operations are seasonal in nature. Typically, sales are lowest in our first quarter ending June 30 of each fiscal year. Customers may also request product returns and we may agree, at our discretion, to the return. This could result in unscheduled payments, which may have an adverse effect on our financial condition.

We control liquidity risk by managing working capital, cash flows and the availability of borrowing facilities.

MANAGEMENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

We do not use financial derivatives. There has been no change with respect to our overall risk exposure during the year ended March 31, 2011.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments represents the amount that would be received from or paid to counterparties, calculated at the reporting date, to settle these instruments. The carrying values of cash, accounts receivable, and accounts payable and accruals approximate their estimated fair value due to the short-term maturity of these instruments.

MARKET RISK

(a) Interest Rate Risk

Our mortgage was subject to interest rate cash flow risk as the required cash flow to service the debt could fluctuate as a result of the changing bank prime lending rate. The outstanding term mortgage with the lender was fully repaid during the year ended March 31, 2011. We have recently entered into a new credit facility agreement that consists of a demand operating line of credit of \$15.0 million, with interest at the bank's prime lending rate plus 0.75%. No amounts have been drawn on the demand line of credit.

(b) Foreign Exchange Risk

We are currently not exposed to significant foreign currency risk as our revenue, expenses, assets and liabilities that are denominated in foreign currencies are minimal.

CREDIT RISK

Our maximum exposure to credit risk as at March 31, 2011 is the carrying value of our financial assets. We manage credit risk by maintaining bank accounts with reputable financial institutions and only investing in securities that are highly rated, traded in active markets and capable of prompt liquidation.

Our exposure to credit risk related to accounts receivable arises from the possibility that a customer does not fulfil its obligations. This is minimized through a customer base predominantly comprised of well established retailers and wholesalers, a program of credit evaluation of new customers and limits on the amount of credit extended as deemed necessary. We perform continuous evaluation of our accounts receivable and record an allowance for doubtful accounts when necessary. The failure of a large customer would have a significant effect on our financial position.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical accounting policies and estimates are those policies, assumptions and estimates that are most important in the preparation of our consolidated financial statements. The selection of policies requires subjective and complex judgment from many alternatives and estimates involving matters that are inherently uncertain. Those policies, 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.

Our significant estimates include provisions for customer discounts and incentives, allowances for uncollectible accounts, allowances related to risk of return, inventory provisions, the realizing of future income taxes, useful lives of long-lived intangible assets and property and equipment, expected future cash flows used in evaluating long-lived assets for impairment, percentage completion of contracted service expenditures and stock-based compensation fair values. On an ongoing basis, we review our estimates to ensure that these values appropriately reflect changes in our business and new information as it becomes available.

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

- revenue recognition;
- intangible assets;
- accrued liabilities;
- contingent liabilities;
- income taxes;
- inventory valuation; and
- stock-based compensation.

REVENUE RECOGNITION

We recognize revenue in accordance with the Canadian Institute of Chartered Accountants (“CICA”) handbook Section 3400 Revenue and Emerging Issues Committee (“EIC”) Abstract 141 Revenue Recognition. This guidance states that revenue recognition should take place when realized or realizable and earned. Revenue recognition occurs upon meeting all of the following criteria:

- evidence of a sales arrangement exists;
- title of goods has passed to the customer, which is generally at the time the goods are delivered;
- sales price is fixed or determinable; and
- product returns can be reasonably estimated or the risk of return has expired.

EIC-141 also states that revenue recognition occurs at the time of the sales transaction where the buyer has the right to return the product only if:

- the seller’s price to the buyer is substantially fixed or determinable at the date of sale;
- the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product;
- the buyer’s obligation to the seller would not be changed in the event of physical destruction, loss or damage of the product;
- the buyer acquiring the product for resale has economic substance apart from that provided by the seller;
- the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer; and
- the amount of future returns can be reasonably estimated.

We recognize revenue when the title and risk of ownership transfers to the customer, and the above criteria are satisfied, which is generally at the time of delivery of products to customers. Net revenue represents total gross revenues less allowances for customer credits, including estimates of discounts and allowances, rebates, charge-backs, and product returns.

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 Afexa and/or our competitors;
- analysis of sales data gathered by a third-party data provider;
- the effect of regulatory changes; and
- the estimated remaining shelf life of products.

We use internal forecasts, historical sales data, information gathered from customers and external data providers and judgment, to determine the estimated amount of product sold to retail customers, product in the sales channel or customer inventories, and to assess risk of returns. Consistent with industry practice, we periodically offer promotional discounts or allowances to our existing customer base. Where product is 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 we offer the program. Discounts and allowances vary by customer, marketing program and time of the year. Discounts in excess of recognized revenue are charged to costs of goods sold or to sales and marketing expense, depending on the nature of the discount or allowance.

INTANGIBLE ASSETS

Intangible assets include patents, registered trademarks, computer software, and website development costs and are recognized at cost less accumulated amortization. Amortization of patents and registered trademarks is computed using the straight-line method based on estimated useful lives ranging from ten to twenty years. Website development costs are amortized using the straight-line method using the estimated life of the website and computer software is amortized on a straight-line basis over three years. We amortize intangible assets on a systematic basis to reflect the pattern in which the economic benefits of the asset are consumed, if that basis can be reliably determined. The expected useful life is the period over which the asset contributes directly or indirectly to future cash flows. We determine the useful lives of these intangible assets based on a number of factors, which include legal, regulatory or contractual limitations; known technological advances; anticipated demand; and the presence of competition. A significant change in these factors may require a revision to the expected remaining useful life of an intangible asset, which could have a significant effect on our results of operations.

R&D costs are expensed as incurred unless a development project meets the Canadian GAAP criteria for deferral and amortization. Deferred R&D costs consist of direct and indirect expenditures related to qualifying R&D programs. There were no deferred R&D costs as at March 31, 2011 or March 31, 2010.

ACCRUED LIABILITIES

We engage a significant number of third-party service providers, contract manufacturers and logistics organizations. The basis of accruals is 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.

CONTINGENCIES

In the normal course of business, we may be subject to loss contingencies, such as claims and assessments arising from litigation and other legal proceedings, contractual commitments and indemnities, product liabilities, and tax matters. We are required to accrue for such loss contingencies or expense if it is probable that the outcome will be unfavourable or will take place, and if there is a reasonable estimate of the amount of the loss or expense. Evaluation of our exposure to a loss takes into consideration various factors, including the progress of each contingency, experience with similar contingencies, and consultation with specialists and external legal counsel. We re-evaluate contingencies as additional information becomes available. Given the uncertainties inherent in complex litigation, regulatory processes and other contingencies, these evaluations can involve significant judgment about future events. The ultimate outcome of any litigation or other contingency may be material to our results of operations, financial position and cash flows.

At March 31, 2011, we were involved in legal claims in the normal course of operations. We have reviewed the claims and believe the ultimate resolution of such legal claims will not have a material adverse effect on our financial position and that we have adequately provided, where required, for these legal claims.

INCOME TAXES

Income taxes have been accounted for using the liability method of tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the accounting and income tax bases of an asset or liability. These are measured using the substantively enacted tax rates, regulations and laws of Canadian, United States, and Swiss tax jurisdictions that are anticipated to be in effect when the differences are expected to reverse. The provision for income taxes involves a number of estimates and assumptions. The amount of income earned in the various operating jurisdictions and the rate of taxes payable in respect of that income has an effect on our consolidated income tax rate.

We also enter into certain transactions and arrangements in the ordinary course of business where the tax treatment is not entirely certain and may involve different taxation jurisdictions. As a result, management must make estimates and judgments based on knowledge and understanding of domestic and international tax rules in determining the consolidated tax provision. For example, certain countries in which we operate could seek to tax a greater share of income than we have provided for. The outcome of any audits by taxation authorities may differ from the estimates and assumptions used in determining our

consolidated income tax provisions and accruals. These assessments could have a material effect on our consolidated income tax provision and results of operations, financial position and cash flows for the period in which the tax authorities make such a determination. We may make a valuation allowance on future tax assets primarily relating to operating losses and other carry forward items when we do not believe realization is more likely than not. We must also exercise significant judgment to determine the appropriate amount of valuation allowance to record. Changes in the valuation allowance could significantly increase or decrease the provision for income taxes in a period and affect our results of operations.

INVENTORY VALUATION

Inventories of raw materials and packaging materials, work-in-progress, finished goods and product shipped with risk of return are valued at the lower of cost and net realizable value. Work-in-progress costs include direct materials, labour and an allocation of overhead which are determined on a weighted average basis. We determine estimated annual production levels and allocate overhead costs on that basis. For product shipped with risk of return, the related displays and packaging materials normally included in the value of the inventory, which we do not expect to recover, are expensed when the product is initially shipped to the customer.

Our 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. Our estimate of inventory not reasonably expected to be realized in cash during the normal operating cycle is classified as non-current inventory. Inventory valuation allowances at March 31, 2011 were approximately \$0.6 million (March 31, 2010 – \$1.0 million). The 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.

STOCK-BASED COMPENSATION

We apply the fair value method of accounting for stock-based compensation. The grant date fair value of stock options is estimated using the Black-Scholes option pricing model. Stock-based compensation cost is recognized on a straight-line basis over the expected vesting period of the related instrument. Any consideration paid upon exercise of stock options is recorded as an increase in share capital and the recorded fair value of the related stock option is reclassified from contributed surplus to share capital.

We have a Deferred Share Unit (“DSU”) plan, under which participants are eligible to receive an equivalent cash value of the common shares at a future date, subject to certain conditions. The value of the DSU is equal to the share price at the date of grant. Compensation expense is recognized as stock-based compensation on the date of grant as no vesting conditions apply. Changes in the liability amount due to share price changes after the initial grant date are recognized as stock-based compensation expense in the period in which the change occurs.

We also have a Restricted Share Unit (“RSU”) plan under which participants are eligible to receive an equivalent cash value of common shares, at a future date subject to certain conditions. The value of the RSU is equal to the share price at the date of grant. In the case of RSUs granted for a prior service period, compensation cost is recognized in the period the RSU is granted. In the case of RSUs granted for current or future service periods, the fair value of the grant is based on the intrinsic value of the units granted and compensation cost is recognized over the expected service period of the stock-based compensation. Changes in the liability amount due to share price changes after the initial grant date are recognized as stock-based compensation expense in the period in which the change occurs.

CHANGE IN ACCOUNTING ESTIMATES

During the year ended March 31, 2011, we reviewed the useful lives and consumption patterns of amortization applied to our long-lived intangible assets and property and equipment. As a result of the review, we have prospectively revised the rates and methods of amortization applied to certain of these items. The change in amortization rates is presented below:

	Twelve Months Ended March 31, 2011	Six Months Ended March 31, 2010 and Twelve Months Ended September 30, 2009
Patents	20 years straight-line	20 years straight-line
Computer software	3 years straight-line	50%, declining balance
Website development	3 to 5 years straight-line	Straight-line over the estimated life
Registered trademarks	10 years straight-line	10 years straight-line
Building and building improvements	15 to 25 years straight-line	4 - 10%, straight-line
Lab equipment	5 to 10 years straight-line	20%, declining balance
Furniture and equipment	5 years straight-line	20 - 30%, declining balance
Computer hardware	4 years straight-line	20%, declining balance
Leasehold improvements	Straight-line over term of lease	Straight-line over term of lease

The impact of the above changes to the consolidated statement of earnings and comprehensive income during the year ended March 31, 2011 was not significant.

RECENT ACCOUNTING PRONOUNCEMENTS

Convergence with International Financial Reporting Standards ("IFRS")

Effective for fiscal years beginning on or after January 1, 2011, IFRS will replace Canadian GAAP for Canadian publicly accountable enterprises. We will implement these standards for Afexa beginning on April 1, 2011.

In accordance with IFRS, we will be required to report our results commencing with our fiscal year ending March 31, 2012, with the quarter ending June 30, 2011 being the first set of consolidated financial statements prepared under IFRS. Comparative figures for the quarter ended June 30, 2010 also need to be presented, including an opening balance sheet as at April 1, 2010 and comparative balance sheet as at March 31, 2011, including equity reconciliations from current Canadian GAAP to IFRS, for all three periods. For the year ending March 31, 2011 and comparative year ended March 31, 2010, we continued to report our results in accordance with Canadian GAAP.

Although the conceptual framework of IFRS is similar to that of Canadian GAAP, there are some significant differences on recognition, measurement, and disclosure that are being addressed during our implementation plan.

(a) Project Status

During the fiscal year ended September 30, 2009, we commenced our process to transition to IFRS. We developed an implementation plan of five phases. Below is a summary of the key deliverables for each phase, along with the project status.

1. Preliminary diagnostic and scoping phase: We completed this phase in May 2010. During this phase we: (1) developed our project structure; (2) established an estimated timeline for the plan completion; (3) created a project team to plan for and achieve a smooth transition to IFRS; (4) engaged a public accounting firm to assist with a high-level assessment of the significant differences between Canadian GAAP and IFRS specific to Afexa; and (5) prioritized potentially affected areas based on their financial reporting impact, business impact and overall complexity.
2. Detailed evaluation and design phase: We completed this phase in February 2011. During this phase we: (1) evaluated the IFRS standards, including the transitional provisions of IFRS 1, First-time Adoption of International Financial Reporting Standards; (2) assessed policy alternatives allowed under the standards and any resulting impact to Afexa; (3) selected accounting policies when alternatives were available; and (4) developed draft IFRS consolidated financial statements and note disclosures. Our Audit Committee also reviewed any potential choices of policies and optional exemptions recommended during this phase.

3. Solution development phase: We commenced this phase concurrently with Phase 2 and completed this phase in May 2011. During this phase, we: (1) considered the IFRS conversion on our business processes, including information technology and data systems, internal control over financial reporting, disclosure control and procedures, financial reporting expertise, and other business activities; (2) developed and documented solutions to each business process; and (3) quantified the impact of accounting policies chosen under IFRS at the date of transition and thereafter.
4. Integration phase: This phase of the work plan includes: (1) the approval, testing, and execution of solutions to each business process identified in the third phase; and (2) the collection of financial information necessary to compile IFRS compliant financial statements, including any information required to reconcile Canadian GAAP to IFRS at transition. We are currently executing this phase of the project.
5. Post-implementation review phase: We will commence this stage after the changeover to IFRS and completion of the fourth phase. This phase involves assessing and evaluating the overall project performance.

Our project is currently progressing on schedule and we expect to file our first quarter financial statements under IFRS within the required timeframe.

(b) Accounting Policies and Financial Statement Preparation

We will make most adjustments required on transition to IFRS retrospectively, against opening retained earnings on April 1, 2010. Transitional adjustments relating to those standards, where restatement of comparative figures is not required, will be made on the first day of the fiscal year of adoption being April 1, 2011.

Although we have not yet finalized the full effects of adopting IFRS, the significant areas identified, where we expect accounting policies to differ or where accounting policy decisions are required, are discussed below. These comments should not be regarded as a complete account of changes that will result from IFRS transition. These comments intend to highlight those areas we believe to be the most significant.

- *IFRS 1 Exemptions*

IFRS 1, First-time Adoption of International Financial Reporting Standards, applies only at the time of changeover to IFRS. This standard requires a first-time adopter to select accounting policies that comply with each pronouncement in effect at the start of its first IFRS reporting period, being April 1, 2011 for Afexa, and retrospectively apply those policies as if they were always in effect. However, IFRS 1 provides a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRS. The following are our initial conclusions with respect to the IFRS 1 optional exemptions. Note that these options are subject to ongoing assessment throughout the implementation plan and could still change.

- Intangible assets – We expect to use the historical cost model for each class of our intangible assets.
- Property and equipment – We expect to use the historical cost model for all of our property and equipment, except for our land under capital lease and building located in Edmonton, Alberta.

For our land under capital lease and building, we expect to elect to measure such assets at their respective fair values (as determined by a professional valuator) and use that amount as their deemed cost at April 1, 2010. By electing these assets at their respective fair values, we anticipate the aggregate cost of our land under capital lease and building to approximate \$10.7 million compared to the aggregate \$10.2 million net book value of these assets recognized under Canadian GAAP at April 1, 2010.

- Cumulative translation differences on foreign exchange – We expect to elect the cumulative translation difference, arising on translating our foreign subsidiaries into the Canadian dollar, to be \$nil at April 1, 2010.

- Share-based payments – We expect to elect not to retrospectively apply IFRS 2, Share-Based Payments, to our 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, or deferred share units and restricted share units, we expect not to retrospectively apply IFRS 2 to any liabilities previously settled before April 1, 2010.
- Business combinations – We will apply the business combination exemption in IFRS 1 not to apply IFRS 3, Business Combinations, retrospectively to past business combinations. Accordingly, we will not restate any business combination that took place prior to April 1, 2010.

- *Presentation of Financial Statements (IAS 1)*

We anticipate several changes to the format of our consolidated financial statements and expanded note disclosure upon adoption of IAS 1. In accordance with IAS 1, we will be required to present a separate statement of equity, classify our operating expenses by nature or function, adopt new financial reporting terminology, and be required to increase our financial statement disclosure, especially around the basis for measurements and judgments.

- *Property, Plant and Equipment (IAS 16)*

Under IAS 16, we are required to choose for each class of asset, the historical cost model or the revaluation model for subsequent measurement. We will use the cost model for each class of our assets. In addition, IAS 16 requires depreciation expense to be determined separately for each significant component of an item of property, plant and equipment. This required us to review our current stratification of property and equipment for depreciation purposes.

In addition to the fair value adjustment described above, upon transition to IFRS, we expect to make certain changes to the depreciation categories and residual values that are applicable to components of our building. As a result, all other things remaining equal, we anticipate that during the year ended March 31, 2011, amortization expense under IFRS could be approximately \$30 thousand lower on a quarterly basis than what we currently recognize under Canadian GAAP.

- *Impairment of Assets (IAS 36)*

Under IAS 36, an entity must assess at the end of each reporting period whether there is an indication that an asset may be impaired. When there is an indication of impairment, an impairment test is required. Under IAS 36, the impairment test for finite-lived assets is only one step – comparing the recoverable amount of an asset (on a discounted basis) with the carrying amount.

Under Canadian GAAP, the impairment of long-lived assets with finite lives is a two-step process. In the first step, the carrying amount of an asset is compared 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. We have completed our transitional impairment test under IFRS and expect no impairment of our long-lived assets.

- *Share-Based Payment (IFRS 2)*

Both IFRS 2 – Share-based Payment and CICA 3870 – Stock-based Compensation and Other Stock-based Payments are based on the concept that the fair value of share-based transactions should be recorded in the financial statements. Although these sections are substantially converged, they have certain differences related to how share-based payments are recognized that will affect Afexa. The most significant differences are:

- Graded vesting – Under IFRS, each vesting period is treated as a separate award with compensation cost for each tranche recognized on a straight-line basis over its own distinctive vesting period. Under Canadian GAAP, we currently pool all options within a specific grant and recognize compensation cost of the entire grant straight-line over the vesting period. This change in recognition pattern will likely accelerate the expensing of our option grants;

- Forfeitures – IFRS requires that measurement of share-based transactions be based on the best estimate of the number of equity instruments expected to vest at the end of each reporting period, including estimating forfeitures. Under Canadian GAAP, entities have the option of estimating forfeitures each reporting period or recognizing forfeitures as they occur. We currently recognize forfeitures as they occur; and
- Disclosure – IFRS has expanded disclosure requirements over Canadian GAAP.

We are currently in the process of finalizing the quantitative impact of this accounting policy change.

- *Revenue (IAS 18)*

The current general principles for revenue recognition are very similar between IFRS and Canadian GAAP and the concepts of IAS 18 are mainly consistent with Canadian standards. However, IAS 18 contains less detailed rules than Canadian GAAP. Given the lack of detailed rules and guidance under IAS 18, judgment is required in defining our IFRS policies for revenue recognition.

In substantially all aspects of revenue recognition, our current accounting policies under Canadian GAAP will continue to be acceptable under IFRS. As a result, we do not expect any significant quantitative differences to exist in regards to revenue recognition upon adoption of IFRS.

However, in June 2010, the International Accounting Standards Board (“IASB”) and Financial Accounting Standards Board (“FASB”) published a joint exposure draft on revenue recognition that could significantly impact the accounting for, and presentation of, revenue if implemented in its current form. The future effect on us has not yet been determined. We will continue to monitor developments in this area.

- *Intangible Assets (IAS 38)*

Although many of the basic underlying principles of IAS 38 are similar to those under Canadian GAAP for intangible assets, there are some predominant differences. Under IFRS, entities may only capitalize website development costs if they can demonstrate how a website will generate probable and measurable future economic benefit (i.e. website is capable of generating revenues directly). As Afexa’s websites are primarily used for promotional and marketing activities, our capitalized website costs with a carrying value at April 1, 2010 of \$0.2 million will be derecognized upon transition to IFRS. In addition, \$0.1 million of website development costs capitalized under Canadian GAAP during the year ended March 31, 2011 will be re-characterized as a sales and marketing expense.

- *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. We do not expect any financial impact to Afexa upon adopting IAS 17.

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 some of our property leases. The Boards continue to receive comments on the proposed standard and plan on issuing the new standard by June 30, 2011. We continue to monitor developments in this area.

- *Income Taxes (IAS 12)*

The application of IFRS and Canadian GAAP accounting for income taxes to Afexa are similar. However, various changes in accounting policies under IFRS will impact the corresponding deferred tax asset or liability. In addition, under IAS 12, we will be required to reclassify deferred tax assets and liabilities from current to non-current presentation.

The IASB currently has several projects underway in its work plan with anticipated completion dates in calendar years 2011 and 2012. We expect these projects to result in new or amended IFRS pronouncements. We will continue to monitor standard developments issued by IASB and regulatory developments issued by the Canadian Securities Administrators, and assess their impact on our first and subsequent IFRS reporting periods.

Finalization of our implementation plan is necessary before we can fully quantify the impact of adopting IFRS on our consolidated financial statements.

(c) Information Technology and Data Systems

Information technology and data system changes may be required to support any changes made to our recognition and measurement of financial information and compilation of disclosure information due to adopting IFRS. We currently expect minimal changes will be required to our information technology systems.

(d) Internal Control over Financial Reporting and Disclosure Controls and Procedures

As we adopt accounting policies under IFRS, we are reviewing our ICFR and DC&P controls to ensure the integrity of such controls will remain under the new IFRS reporting environment. We currently expect minimal changes to our ICFR and DC&P upon transition to IFRS.

(e) Financial Reporting Expertise

As part of Phase 1 of our implementation plan, we conducted initial IFRS awareness training of key finance and operational staff. During this session, external consultants provided an overview of IFRS and potential implications of IFRS on our business.

In addition, all members of the project team have attended external training seminars on IFRS and we are continuing to provide ongoing training and education to our staff on IFRS throughout the implementation plan. Regular progress reporting within the project team and the Audit Committee on the status of the implementation project is also ongoing.

(f) Business Activities

Throughout our implementation plan, we are considering business activities that may be impacted by the conversion to IFRS, including covenant compliance, compensation arrangements and tax planning. At this time, we have not discovered any current or future anticipated business activity significantly impacted by the transition to IFRS. Minimal changes will be required to align our budgeting and forecasting processes and presentation for IFRS requirements.

(g) Opening Consolidated Statement of Financial Position under IFRS

In summary, on transition to IFRS, we expect our opening shareholders' equity at April 1, 2010, to increase by \$0.7 million. The most significant adjustments impacting our opening shareholders' equity are described in further detail in section (b) above and are summarized in the unaudited table below. This information reflects our most recent views, assumptions, and expectations. However, circumstances may arise, such as changes in IFRS standards or in interpretations of IFRS standards, which could alter this information.

Estimated Impact of Adopting IFRS

(in thousands)

Description of Change	Balance Sheet Category	Increase (Decrease) in Shareholders' Equity
Adjustment of land and building to fair value	Property and equipment	\$ 512
Derecognition of website development costs	Intangible assets	(206)
Income tax impact of above adjustments	Future income taxes	414
Total estimated after-tax impact on shareholders' equity		\$ 720

NON-GAAP FINANCIAL MEASURES AND RECONCILIATIONS

We use both GAAP and certain non-generally accepted accounting principles (“non-GAAP”) measures to assess performance. We believe these non-GAAP 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-GAAP financial measures as a substitute or superior to the measures of financial performance prepared in accordance with GAAP.

Normally, a non-GAAP 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 GAAP. Working capital, EBITDA, and cash flow prior to working capital changes are not measures of financial performance (nor do they have standardized meanings) under GAAP. 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 March 31, 2011	As at March 31, 2010
Current assets	\$ 22,277	\$ 29,838
Current liabilities	9,515	12,335
Working capital	\$ 12,762	\$ 17,503

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 GAAP, 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 GAAP:

<i>(in thousands)</i>	Year Ended March 31, 2011	Six Months Ended March 31, 2010	Year Ended September 30, 2009
Net (loss) earnings	\$ (828)	\$ 2,789	\$ 1,301
Current income taxes (recovery)	(451)	1,915	1,267
Future income taxes (recovery)	70	(392)	(324)
Amortization	1,379	734	1,311
Interest and bank charges	289	180	400
Interest income	(58)	(37)	(194)
EBITDA	\$ 401	\$ 5,189	\$ 3,761

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 swings 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 provided by (used in) operating activities, the most directly comparable financial measure calculated and presented in accordance with GAAP:

<i>(in thousands)</i>	Year Ended March 31, 2011	Six Months Ended March 31, 2010	Year Ended September 30, 2009
Cash (used in) provided by operating activities	\$ (7,269)	\$ 15,871	\$ (2,676)
Change in non-cash operating working capital	9,050	(12,410)	6,016
Change in deferred revenue	180	(213)	–
Change in non-current inventory	(243)	243	(116)
Cash flow prior to working capital changes	\$ 1,718	\$ 3,491	\$ 3,224

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:

- *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;*
- *expectation that through improved inventory management and purchasing practices, we are targeting to continue to achieve annual gross margins in excess of 70% in the future;*
- *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 and that we will launch this product into the Canadian marketplace with shipments to retail customers commencing in the summer of 2011;*
- *belief that our preclinical studies and preliminary signals from our pilot clinical study indicate that our proprietary formulation related to cholesterol management may have potential to manage abnormal cholesterol;*
- *expectation that expansion of our direct sales retail model to include the Province of Ontario will help accelerate our revenue growth in that province;*
- *ability to apply for FDA botanical drug registration and whether such application would lead to registration and, if successful, whether such registration would help better position us in the United States marketplace;*
- *belief that our future cash generated from operating activities and the availability of our operating line of credit will be sufficient to fund both our working capital needs and research and development activities beyond the next twelve months;*
- *intention to exercise our option to purchase our land held under capital lease on or before the expiration of the lease; and*
- *projection that capital expenditures for the year ending March 31, 2012 will be between \$1.0 million and \$1.4 million.*

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 Province 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.