



Afexa Life Sciences Inc.

Q2

**SECOND
QUARTER
REPORT**

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

For the three and six months ended
September 30, 2010



Management's Discussion and Analysis

for the three and six months ended September 30, 2010

The following Management's Discussion and Analysis ("MD&A") for Afexa Life Sciences Inc. ("Afexa" or "the Company") was prepared as of November 8, 2010 to assist readers in understanding our consolidated financial performance for the three and six months ended September 30, 2010. This MD&A should be read in conjunction with the accompanying unaudited interim consolidated financial statements for the three and six months ended September 30, 2010 and the notes contained therein. In addition, this MD&A should be read in conjunction with the MD&A and audited consolidated financial statements for the six months ended March 31, 2010. 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. 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 dated June 24, 2010, MD&A and audited financial statements, is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

OUR BUSINESS

We are a life sciences and technology company founded in 1992 and headquartered in Edmonton, Alberta, Canada. We have developed, commercialized and patented a proprietary technology, known as ChemBioPrint, which is used in the discovery and biological standardization of natural products that deliver consistent, verifiable and provable health benefits. Using the ChemBioPrint® product discovery and standardization platform, our scientists are able to 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 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, 52 weeks ending September 25, 2010).

QUARTER HIGHLIGHTS

- Revenue for the three months ended September 30, 2010 was \$19.2 million reflecting an increase of 23% from the same quarter in 2009;
- We reported net earnings of \$5.1 million or \$0.05 per share during the quarter compared to net earnings of \$2.8 million or \$0.03 per share in the comparative three-month period ended September 30, 2009;
- In October 2010, we signed an in-license agreement whereby we were granted the exclusive Canadian rights to use, develop, market, sell and distribute a proprietary natural health product for the treatment of cold sores. This product has been clinically proven to shorten the healing time and relieve the pain associated with cold sores;
- We recently 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;
- We paid out our Edmonton facility mortgage of \$5.0 million during the quarter. We have also entered into a new credit facility agreement that, among other things, consists of an operating line of credit of \$15.0 million. The credit facility is currently undrawn; and
- In October 2010, we renewed our normal course issuer bid ("NCIB") with the Toronto Stock Exchange. Under our immediately preceding NCIB, we repurchased 655,354 common shares at a weighted average trading price of \$0.64 per share.

Summary of Consolidated Financial Results

(in thousands except for per share amounts)	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Revenue	\$ 19,189	\$ 15,557	\$ 20,947	\$ 21,751
EBITDA ¹	7,549	3,922	2,488	3,103
Net earnings	5,124	2,782	1,049	1,662
Earnings per share – basic and diluted	0.05	0.03	0.01	0.02
Cash flow prior to working capital changes ¹	5,706	3,342	2,484	3,047

	As at September 30, 2010	As at March 31, 2010
Working capital ¹	\$ 14,386	\$ 17,503
Total assets	39,821	44,077
Total long-term debt and obligations under capital lease (including current portion)	879	6,027
Shareholders' equity	26,970	25,795

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

OVERALL PERFORMANCE

During the quarter ended September 30, 2010, we achieved revenue of \$19.2 million, reflecting a 23% increase over the same three-month period in 2009. Strong demand from retailers that were stocking up on cold and flu products prior to the fall and winter cold and flu season caused this increase. On a year-to-date basis, revenue for the six months ended September 30, 2010 of \$20.9 million was comparable to the revenue we achieved in the same six-month period of 2009.

In addition to higher revenue, we also generated a higher gross margin during the quarter. Gross margin increased to 75.5% during the three months ended September 30, 2010 from a margin of 61.8% in the prior year, largely due to lower inventory adjustments and obsolescence expenses.

Consistent with the increase in our revenue and gross margin, net earnings also increased to \$5.1 million or \$0.05 per share during the quarter. This compares to net earnings of \$2.8 million or \$0.03 per share achieved in the comparative quarter ended September 30, 2009.

In the past year, we changed our financial year-end from September 30 to March 31 to better synchronize our financial reporting and business planning with our natural business cycle. The following table presents our financial results on a trailing twelve-month basis for the past two fiscal years (using our old financial year-end of September 30):

Summary of Annual Financial Results

(in thousands except for per share amounts)	12 month periods ended September 30	
	2010	2009
Revenue	\$ 55,321	\$ 47,592
EBITDA ¹	7,677	3,761
Net earnings	3,838	1,301
Earnings per common share—basic and diluted	0.04	0.01

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

On a twelve-month trailing basis, we were able to achieve both revenue and profit growth. Revenue for the twelve months ended September 30, 2010 increased by \$7.7 million or 16% over the same twelve-month period in 2009 as our lead product, COLD-FX, continued to gain recognition among consumers in Canada. Similarly, net earnings also increased by \$2.5 million to \$3.8 million in the twelve-month period compared to the prior year.

Moving into our next quarter ending December 31, 2010, we expect revenue to be strong as we enter the core of the winter cold and flu season. However, our actual revenue results will be highly dependant on the incidence of cold and flu activity in Canada and the related consumer demand for COLD-FX as the majority of our large retail customers entered this season well stocked with our product.

We believe revenue during last year's quarter ended December 31, 2009 was unusually high, largely driven by the presence of H1N1, a pandemic strain of the flu. Revenue during this year's quarter ending December 31, 2010 should be more normal for this time of year and will not be as strong as the same period last year (see "Advisory Regarding Forward-looking Statements").

COLD-FX also continues to be the number one pharmacist and doctor recommended natural cold remedy as reported by Drugstore Canada's and L'actualite Pharmaceutique's 2009 / 2010 Survey on OTC Counseling and Recommendations and The Medical Post's 2009 / 2010 Survey on OTC Counseling & Recommendations, respectively. In addition, COLD-FX remains the number one selling cold and flu remedy in Canada for the 52 week period ended September 25, 2010, per point of sales data received from the Neilsen 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 to develop new products; and
- In-licensing third-party products that fit our profile.

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. A number of public relations, social media and marketing events are being conducted to broaden consumer awareness of IMMUNITY-FX. We have also initiated programs to educate pharmacists and doctors of the benefit of recommending this product to their patients (see "Advisory Regarding Forward-looking Statements").

COLD SORE

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, develop, market, sell and distribute Lisoma's proprietary natural health product for the treatment of cold sores.

The product 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. This product has been clinically proven to shorten the healing time and relieve the pain associated with cold sores. We believe this product will be beneficial to the approximately 20% of Canadians that get cold sores (see "Advisory Regarding Forward-looking Statements").

CHOLESTEROL MANAGEMENT

Using our ChemBioPrint technology, we have developed a product designed to manage cholesterol levels. Pre-clinical studies of this proprietary formulation, LIP-01, have shown that it has the potential to prevent and manage diseases associated with elevated cholesterol. A pilot clinical trial is currently underway and is designed to identify optimum dosing levels and determine safety and tolerability. Preliminary data signals from our pilot clinical trial suggest similar efficacy to our pre-clinical studies (see "Advisory Regarding Forward-looking Statements"). A full international patent application has been filed to protect LIP-01's composition, manufacturing process, and therapeutic use.

COLD-FX PEDIATRICS

A multi-centre clinical trial was recently launched 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. Volunteers will take 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 will be recruited from Halifax, Edmonton, and St. John 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.

SEASONAL ALLERGY

Positive pre-clinical lab studies examining the potential of the core active ingredient in COLD-FX and IMMUNITY-FX, in asthma and allergy-related indications have been completed. A randomized, placebo-controlled, double-blind clinical trial involving 200 participants with seasonal allergic rhinitis is now in progress. We are targeting to receive results from this study within the next 12 months (see "Advisory Regarding Forward-looking Statements").

CANCER

Positive pre-clinical lab studies in leukemia have been conducted in collaboration with McGill University. A National Cancer Institute supported and Wake Forest University ("WFU") led multi-centre clinical trial is currently undergoing final analysis, with encouraging initial signals showing reductions in some acute respiratory infection symptoms and reduction in serious adverse events. Further clinical study is in the planning stages with WFU.

BRAIN HEALTH

We are continuing to investigate the core active ingredient in REMEMBER FX® and MEMORY-FX®, HT1001™, in healthy aging adults. Previous clinical trials have shown that HT1001 improves memory in generally healthy adults, improves working memory in schizophrenia patients and reduces 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 botanical toll-like receptor ("TLR") modulators. These are a class of molecules that can target multiple organs and tissues, including specific immune cells and have the potential to 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 effect on increasing glucose uptake in cultured skeletal muscle cells. An open-labelled clinical trial is being planned to investigate dose ranging and safety.

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 are increasing our pharmacist and doctor education programs in this province and are designing 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 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. Thus, we are no longer relying only on a broker-type strategy in this province. We expect to achieve significant revenue growth over the next year in this geographic location (see “Advisory Regarding Forward-looking Statements”).

UNITED STATES

We believe that certain Afexa products potentially fit the criteria for development under a relatively new drug industry defined by the United States Food and Drug Administration (“FDA”) as the botanical drug industry. The Investigational New Drug (“IND”) process for botanical drugs serves as the basis for a New Drug Application (“NDA”) to permit the marketing of a polymolecular based botanic 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 as the NDA must contain evidence of safety and effectiveness (derived from adequate and well-controlled clinical studies), and adequate information on chemistry, manufacturing and controls (“CMC”). We are considering seeking botanical drug registration 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 modest 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 THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2010

REVENUE

Revenue and Gross Profit Summary

(in thousands)	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Revenue	\$ 19,189	\$ 15,557	\$ 20,947	\$ 21,751
Cost of goods sold	4,695	5,950	5,683	6,816
Gross profit	14,494	9,607	15,264	14,935
Gross margin %	75.5%	61.8%	72.9%	68.7%

As mentioned earlier in this MD&A, during the three months ended September 30, 2010, our revenue increased by 23% to \$19.2 million from revenue of \$15.6 million reported in the same three-month period of 2009. Strong demand from our large retail customers that were stocking up on cold and flu products prior to the fall and winter cold and flu season caused this increase.

On a year-to-date basis, revenue for the six months ended September 30, 2010 of \$20.9 million was slightly below the revenue achieved in the same six-month period of 2009. During the first quarter ended June 30, 2010, we experienced relatively weak demand for our product as retailers exited last year's cold and flu season well stocked with COLD-FX product. This was largely caused by the regular flu season for the 2010 winter months being unusually mild following the abatement of the fall 2009 pandemic flu strain. In addition, as lower prevalence of flu continued into the 2010 summer period, retailers did not need to place replenishment orders for COLD-FX. This seasonal weakness during our first quarter offset the revenue growth we achieved during the second quarter ended September 30, 2010.

GROSS MARGIN

Gross margin for the three and six months ended September 30, 2010 was 75.5% and 72.9%, respectively, as compared to 61.8% and 68.7%, respectively, for the corresponding periods in 2009. We continue to work to improve our inventory management processes to achieve lower production costs and reduce obsolescence related inventory write-downs. Improvements in these areas caused our gross margin to improve during the three and six months ended September 30, 2010. Through improved inventory management and purchasing practices, we are targeting to achieve annual gross margins in excess of 70% in the future (see "Advisory Regarding Forward-looking Statements").

GENERAL AND ADMINISTRATION

General and administration costs increased by \$0.8 million to \$2.7 million during the second quarter of fiscal 2011 from \$1.9 million reported in the same period of the previous year. Additional investments in corporate development activities and new management personnel over the past twelve months to further our business development and growth strategies caused a portion of this increase. In addition, our employee variable short-term incentive expense increased over the prior year as the Company met certain revenue and EBITDA related targets for the twelve-month period ended September 30, 2010 that were not met in the prior year.

On a six-month basis, general and administration costs declined by \$0.2 million to \$5.0 million from the same six-month period in 2009. Contributing to the decline were costs totalling \$1.1 million in the prior fiscal year related to legal, professional and settlement costs associated with an agreement reached with the Alberta Securities Commission as well as severance related costs of \$0.4 million. These costs did not reoccur in the six months ended September 30, 2010 and fully offset the cost increases discussed in the immediately preceding paragraph.

SALES AND MARKETING

Sales and marketing expenses were \$2.7 million for the three months ended September 30, 2010, which was consistent with the expense recognized in the comparable three months ended September 30, 2009. On a year-to-date basis, sales and marketing expenses increased by \$0.3 million to \$4.8 million from the same six-month period in 2009. Over the past twelve months, we have been expanding our sales and marketing resources to further our presence in the Canadian marketplace. To further enhance our skill sets and plan for succession in this area, we are also currently recruiting for the position of a senior vice president of sales and marketing.

RESEARCH AND DEVELOPMENT

Research and development costs increased to \$1.3 million during the three months ended September 30, 2010 from costs of \$0.9 million in the previous year. Over the past twelve months, we have continued to focus more resources towards research and development activities to reduce the time required to complete research on new product development and commence clinical trials. The increase in expenditures during the quarter related primarily to increases in staff and an increase in clinical trial activity. On a year-to-date basis, research and development costs also increased to \$2.5 million from \$1.8 million in the same six-month period of 2009. 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 scientific research and experimental development ("SRED") tax credits and grants.

Partially offsetting research and development costs in the six-month period ended September 30, 2010 were \$0.2 million (six months ended September 30, 2009 – \$0.3 million) of SRED tax credits.

STOCK-BASED COMPENSATION

We recognized stock-based compensation expense of \$0.3 million during the three months ended September 30, 2010, which was comparable to the expense recognized in the same three-month period of 2009. On a year-to-date basis, stock-based compensation expense declined to \$0.4 million from \$0.7 million in the same six-month period of 2009. Additional stock-based compensation expense occurred in the prior year because of accelerating the expensing of certain options related to severance.

EBITDA

For the three months ended September 30, 2010, we achieved EBITDA (see "Non-GAAP Financial Measures") of \$7.5 million compared to EBITDA of \$3.9 million reported in the three months ended September 30, 2009. A combination of higher revenue during the quarter and improvements in our gross margin were the key drivers to growing our EBITDA.

On a year-to-date basis, EBITDA of \$2.5 million achieved during the six months ended September 30, 2010 was less than EBITDA of \$3.1 million achieved in the same six-month period of 2009. Despite higher gross profit, we incurred higher expenses related to research and development and sales and marketing activities as well as additional employee variable short-term incentive expense attributable to the Company meeting certain revenue and EBITDA related targets for the twelve months ended September 30, 2010.

INTEREST AND BANK CHARGES

Interest and bank charges increased to \$162 thousand during the quarter from \$79 thousand in the corresponding quarter of the prior year because we incurred additional interest charges and penalties related to the early pay-out of our long-term mortgage in September 2010. These additional expenses also caused our interest and bank charges expense to increase during the six-month period ended September 30, 2010 from the same six-month period in 2009.

AMORTIZATION

We incurred amortization expense of \$0.3 million and \$0.7 million, respectively, during the three and six months ended September 30, 2010, which approximate the amounts reported in the same periods of the prior year. Additional amortization on new equipment purchased over the past twelve months has been offset by older assets becoming fully amortized.

INCOME TAXES

During the quarter, we recognized income tax expense of \$2.0 million, representing an effective income tax rate of 27.8% on earnings before income taxes of \$7.1 million. During the six months ended September 30, 2010, we recognized income tax expense of \$0.5 million, representing an effective income tax rate of 33.9% on earnings before income taxes of \$1.6 million. We experienced a higher effective tax rate during the six-month period because of non-deductible expenses having a proportionately larger impact on income tax expense as a percentage of earnings before income taxes than they did for the quarter ended September 30, 2010.

During the comparative six months ended September 30, 2009, we incurred income tax expense of \$0.6 million, representing an effective tax rate of 27.9%.

NET EARNINGS

We reported net earnings of \$5.1 million during the quarter ended September 30, 2010, reflecting an increase of \$2.3 million from the comparative quarter ended September 30, 2009. Higher revenue and gross profit caused this increase. On a year-to-date basis, we recognized net earnings of \$1.0 million, reflecting a decline of \$0.6 million from the six-month period ended September 30, 2009, due primarily to higher research and development and sales and marketing costs, as discussed earlier in this MD&A.

QUARTERLY INFORMATION

(in thousands except for per share amounts)	For quarters ended							
	Sep. 30 2010	Jun. 30 2010	Mar. 31 2010	Dec. 31 2009	Sep. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008
Revenue	\$ 19,189	\$ 1,758	\$ 4,827	\$ 29,547	\$ 15,557	\$ 6,195	\$ 6,119	\$ 19,721
Net earnings (loss)	5,124	(4,075)	(4,027)	6,816	2,782	(1,120)	(3,168)	2,807
Earnings (loss) per common share – basic and diluted	0.05	(0.04)	(0.04)	0.06	0.03	(0.01)	(0.03)	0.03

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

We aim to time marketing expenditures with the anticipated increase in cold and flu activity; however, depending on specific marketing programs, these expenditures may not fall within the quarters from which revenue is derived. We believe that, due to the uncertain economic conditions that prevailed in the second quarter of 2009, many of our retail customers reduced levels of store inventories. As a result, lower revenue was achieved in the quarter ended March 31, 2009, thus resulting in a higher than expected loss for that quarter. Starting in the quarter ended June 30, 2009, public awareness of flu increased with an increase in the incidence of flu and the associated World Health Organization announcement, and media coverage thereon, of 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 the pandemic strain of the flu declined and retailers were well stocked with cold and flu products. Lower 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.

LIQUIDITY AND CAPITAL RESOURCES

Our main source of capital during the six months ended September 30, 2010 was our cash on hand provided from operating activities in prior periods. The primary use of our cash during the six-month period 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

(in thousands)	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Cash flow prior to working capital changes ¹	\$ 5,706	\$ 3,342	\$ 2,484	\$ 3,047
Cash provided by (used in) operating activities	1,111	(1,358)	(7,516)	(4,235)

	As at	As at
	September 30, 2010	March 31, 2010
Cash	\$ 4,189	\$ 17,685
Working capital ¹	14,386	17,503
Long-term debt and obligations under capital lease (including current portion)	879	6,027

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

CASH AND WORKING CAPITAL

At September 30, 2010, we had \$4.2 million of cash on hand. This compares to \$17.7 million in cash at March 31, 2010. During the six months ended September 30, 2010, we utilized cash on hand to fund our working capital needs, complete capital expenditures, and repay our outstanding mortgage.

Our working capital position at September 30, 2010 was \$14.4 million (March 31, 2010 – \$17.5 million). The decrease of \$3.1 million from March 31, 2010 is primarily due to paying out our long-term mortgage during the period.

CASH USED IN OPERATING ACTIVITIES

Cash flow prior to working capital changes was \$2.5 million in the six months ended September 30, 2010 compared with \$3.0 million in the same period of the prior year. Lower earnings during the six-month period ended September 30, 2010 caused this decline. Including changes in working capital items, we utilized \$7.5 million in cash from operating activities during the six months ended September 30, 2010 as we used cash on hand to build up inventory levels and pay required income tax instalments. In addition, accounts receivable increased significantly during the period as certain sales to customers in August and September had not yet been fully collected as of September 30, 2010.

CASH USED IN INVESTING ACTIVITIES

Capital expenditures for the six months ended September 30, 2010 included purchases of property and equipment of \$0.3 million and additions to intangible assets of \$0.3 million. These expenditures were incurred primarily for lab and computer equipment as well as for patent and trademark costs associated with new product development.

CASH USED IN FINANCING ACTIVITIES

During the six months ended September 30, 2010, we repaid our mortgage in full and repurchased common shares under our NCIB resulting in net cash used in financing activities of \$5.3 million.

AGGREGATE CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET FINANCING

During the quarter ended September 30, 2010, we paid out the mortgage on our Edmonton facility of \$5.0 million.

We have 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 will be 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").

In addition, we enter into operating and capital leases and purchasing agreements in the ordinary course of our business. 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.

We project that capital expenditures for the year ending March 31, 2011 will approximate \$1.0 million to \$1.5 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").

CLASS ACTION LAWSUIT

In 2007, two concurrent and coordinated class action lawsuits were commenced in Alberta and Ontario against the Company and certain of our officers and former directors. These lawsuits sought compensatory damages, costs, and expenses in the amount of \$110 million each. On September 16, 2009, we announced we had reached an agreement in principle, subject to court approval, to settle the proposed class action lawsuits. On August 5, 2010, we announced that the Ontario Superior Court of Justice had dismissed the proposed Ontario class action lawsuit in conjunction with its approval of the settlement of all related claims. As part of the settlement and in conjunction with the Ontario Court Order, the Alberta Court of Queen's Bench dismissed the related proposed Alberta class action lawsuit. The settlement agreement provides for the settlement, release and dismissal of all claims asserted against the Company, our former auditors and the individual proposed defendants and does not in any way constitute any admission of liability by Afexa or our officers, directors or employees. Our portion of the settlement amounts to \$6.6 million, which will be funded through our insurance coverage. We anticipate that the settlement will close early in the 2011 calendar year (see "Advisory Regarding Forward-looking Statements").

RELATED PARTY TRANSACTIONS

Included in general and administration expenses during the three and six months ended September 30, 2010, were management consulting fees of \$nil and \$32 thousand, respectively (three and six months ended September 30, 2009 – \$nil) incurred from a company controlled by a director of Afexa. These expenses occurred in the normal course of operations and were measured at their exchange amounts, which were established and agreed to as consideration by the related parties.

OUTSTANDING SHARES AND STOCK OPTIONS

We are authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at November 8, 2010, 104,258,814 common shares were outstanding (September 30, 2010 – 104,258,814 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 have been granted options to purchase common shares under our stock option plan. At November 8, 2010, 5,223,684 options were outstanding (September 30, 2010 – 5,223,684 and March 31, 2010 – 5,658,684).

NORMAL COURSE ISSUER BID

Effective October 18, 2010, we renewed our NCIB with the Toronto Stock Exchange. Under the NCIB, we are entitled to repurchase up to 5,212,941 common shares, representing 5% of our then issued and outstanding common shares. The NCIB will terminate on October 17, 2011. Under our immediately preceding NCIB, we repurchased 655,354 common shares at a weighted average trading price of \$0.64 per share.

OUTLOOK

Moving into our next quarter ending December 31, 2010, we expect revenue to be strong as we enter the core of the winter cold and flu season. However, our actual revenue results will be highly dependant on the incidence of cold and flu activity in Canada and the related consumer demand for COLD-FX as the majority of our large retail customers entered this season well stocked with our product.

We believe revenue during last year's quarter ended December 31, 2009 was unusually high, largely driven by the presence of H1N1, a pandemic strain of the flu. Revenue during this year's quarter ending December 31, 2010 should be more normal for this time of year and will not be as strong as the same period last year (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.

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 our growth initiatives.

RISKS AND UNCERTAINTIES

Our business is subject to certain risks and uncertainties related to financial risks (including liquidity, interest rate, foreign exchange, credit and litigation risk); operational risks (including market, product, seasonality of demand, product development, material supply and reliance on third party risks); regulatory approvals, and health and safety risks. Further discussion regarding these and other risks can be found in our March 31, 2010 annual MD&A and Annual Information Form dated June 24, 2010 available on the SEDAR website at www.sedar.com.

Prior to making any investment decision regarding Afexa, investors should carefully consider, among other things, the risks described within this MD&A and the business risks and factors set forth in our March 31, 2010 annual MD&A and Annual Information Form dated June 24, 2010. Other than as discussed elsewhere in this MD&A, our business risks and factors for the three and six months ended September 30, 2010 are substantially the same as disclosed in our annual MD&A, and are incorporated by reference herein. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business and operations.

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

We have evaluated whether there were changes in our internal controls over disclosure and financial reporting during the most recent interim period ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect our DC&P and ICFR. No material changes were identified for the period.

We continue to work on implementing control enhancements to address the material weaknesses described in our 2010 year-end MD&A. As control enhancements have not been fully implemented and evaluated for effectiveness for all identified deficiencies, we have concluded that disclosure controls and procedures, and internal controls over financial reporting are ineffective.

The following activities were performed during the period to further remediate identified material control deficiencies:

- To estimate the value of trade promotions offered to our customers, we previously relied on end user computing tools which lacked sufficient application controls. To remediate this weakness, we licensed and implemented a trade promotion management application. Throughout the period we continued to improve internal review processes to minimize the risk of error in trade promotion estimation processes;
- We identified weaknesses in several of our financial reporting estimation processes, including estimation of accrued liabilities. To remediate these weaknesses, we redesigned a number of our estimation processes and supporting controls. Control enhancements were implemented during the period; and
- As a result of the year-end information technology control evaluation, we also identified a number of key control weaknesses related to logical access controls and change management procedures. Although we believe these have not resulted in a misstatement of consolidated financial results, when aggregated, these deficiencies represent a material weakness in our control environment. Throughout the period, we redesigned and implemented enhanced processes and controls.

Further discussion regarding DC&P and ICFR can be found in our March 31, 2010 annual MD&A.

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 our 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 period represented at the date of the financial statements. Actual results could differ from these estimates.

Our significant estimates include provisions for customer discounts and incentives, allowances for uncollectible accounts, risk of return, the realizable portion of inventory during our normal business cycle, 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.

During the six months ended September 30, 2010, 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 our review, we prospectively revised the rates and methods of amortization applied to certain of these items.

During the six months ended September 30, 2010 we provided for amortization on our intangible assets and property and equipment using the following methods and rates:

Patents	20 years straight-line
Computer software	3 years straight-line
Website development	3 to 5 years straight-line
Registered trademarks	10 years straight-line

Building and building improvements	15 to 25 years straight-line
Lab equipment	5 to 10 years straight-line
Furniture and equipment	5 years straight-line
Computer hardware	4 years straight-line
Leasehold improvements	Straight-line over term of lease

The impact of the above changes to the statement of earnings and comprehensive income during the six months ended September 30, 2010 was not significant.

Further discussion regarding our critical accounting policies and estimates can be found in our annual MD&A for the six months ended March 31, 2010.

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 reconciled from current Canadian GAAP to IFRS. For the year ending March 31, 2011 and comparative year ended March 31, 2010, we will continue 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 will be 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, which are outlined in the MD&A for the six months ended March 31, 2010.

The preliminary diagnostic and scoping phase was completed in May 2010. We are currently working concurrently on our detailed evaluation and design and solution development phases and expect to have the detailed evaluation and design phase completed by the end of December 2010. Our project is progressing on schedule.

(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 for Afexa.

Although we have not yet determined the full effects of adopting IFRS, the areas identified to date, where we expect accounting policies to differ or where accounting policy decisions are required, are discussed below. These changes in accounting policies could impact our consolidated financial statements and have been reviewed by our Audit Committee.

- **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 first-time adopters 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 method for each class of our intangible assets and use that amount as their deemed cost at April 1, 2010.
- **Property and equipment.** We expect to use the historical cost model and use that amount as the deemed cost at April 1, 2010 for all of our property and equipment, except for our land under capital lease and building.

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 March 31, 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 zero at April 1, 2010.
- **Share-based payments.** We expect to elect not to apply retrospective application of 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 apply retrospective application of IFRS 2 to any liabilities previously settled before 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 significantly increase our financial statement disclosure, especially around the basis for measurements and judgments.

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

Consistent with Canadian GAAP, we can continue to recognize our property and equipment initially at cost. However, 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 currently expect to 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 will require us to review our current stratification of property and equipment for depreciation purposes. Doing so will likely result in more depreciation categories, and potential acceleration of depreciation in certain cases, than what is currently practiced 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 definite-lived intangible 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 intangible assets with definite 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 are currently in the process of conducting our transitional impairment test under IFRS.

- **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 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 quantifying the 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 \$206 thousand will be derecognized upon transition to IFRS. In addition, any website costs capitalized during the year ended March 31, 2011 will be re-characterized as an expense upon the adoption of IFRS.

- **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. Although we do not expect the quantitative impact of adopting IAS 17 to be significant, we are still assessing the potential quantitative impact on our financial statements.

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.

The IASB currently has several projects underway in its work plan with anticipated completion dates in calendar years 2010 and 2011. These projects are expected 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.

Further, continued progress of our implementation plan is necessary before we can quantify the overall accounting effects of adopting IFRS on our consolidated financial statements. However, in subsequent periods we intend to disclose any financial impacts once they become known.

(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. To date, we have not identified many significant changes that will be required to our information technology or data systems because of adopting IFRS. However, continued progress of our implementation plan is necessary before we can fully conclude on our information technology and data system impacts.

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

As we adopt accounting policies under IFRS, we plan to review and modify ICFR and DC&P controls to ensure the integrity of such controls will remain under the new IFRS reporting environment. We intend to disclose any significant impacts to such controls in our future filings.

Going forward, in interim and annual reports, we plan to provide ongoing disclosure on our IFRS implementation plan, including specifics of accounting policy changes, outlines of key differences between current practice and IFRS, and, when possible, illustrative disclosures and financial statement account reconciliation.

(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, certain members of the project team have attended external training seminars on IFRS. 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.

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.

(in thousands)	As at September 30, 2010	As at March 31, 2010
Current assets	\$ 25,943	\$ 29,838
Current liabilities	11,557	12,335
Working capital	\$ 14,386	\$ 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 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 for the three and six months ended September 30, 2010 and 2009:

(in thousands)	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Net earnings	\$ 5,124	\$ 2,782	\$ 1,049	\$ 1,662
Current income taxes	1,989	845	259	662
Future income taxes (recovery)	(20)	(127)	278	(19)
Amortization	305	355	688	681
Interest and bank charges	162	79	242	173
Interest income	(11)	(12)	(28)	(56)
EBITDA	\$ 7,549	\$ 3,922	\$ 2,488	\$ 3,103

The following is a reconciliation of EBITDA to net earnings, the most directly comparable financial measure calculated and presented in accordance with GAAP for the twelve months ended September 30, 2010 and 2009:

(in thousands)	Twelve months ended September 30	
	2010	2009
Net earnings	\$ 3,838	\$ 1,301
Current income taxes	2,174	1,267
Future income taxes (recovery)	(114)	(324)
Amortization	1,422	1,311
Interest and bank charges	422	400
Interest income	(65)	(194)
EBITDA	\$ 7,677	\$ 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.

(in thousands)	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Cash provided by (used in) operating activities	\$ 1,111	(\$1,358)	(\$7,516)	(\$4,235)
Change in non-cash operating working capital	4,523	4,708	10,063	7,302
Change in deferred revenue	180	–	180	–
Change in non-current inventory	(108)	(8)	(243)	(20)
Cash flow prior to working capital changes	\$ 5,706	\$ 3,342	\$ 2,484	\$ 3,047

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 for the upcoming quarter ending December 31, 2010 should be more normal for this time of year and will not be as strong as the same period last year;
- 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;
- expectation that a number of public relations, social media and marketing events will broaden consumer awareness of IMMUNITY-FX and that education programs with pharmacists and doctors will lead to professional recommendations to their patients;
- belief that our new cold sore product will be beneficial to Canadians that get cold sores;
- belief that our preclinical studies and preliminary signals from our pilot clinical study indicate that LIP-01 may have potential to prevent and manage diseases associated with elevated cholesterol;
- expectation that we will receive results from our clinical trial involving 200 participants with seasonal allergic rhinitis within the next 12 months;
- expectation that we will achieve significant revenue growth over the next year in the Province of Quebec through additional marketing efforts;
- 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;
- expectation that through improved inventory management and purchasing practices, we are targeting to achieve annual gross margins in excess of 70% in the future;
- 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 12 months;
- intention to exercise our option to purchase our land held under capital lease on or before the expiration of the lease;
- projection that capital expenditures for the year ending March 31, 2011 will approximate \$1.0 million to \$1.5 million; and
- belief that the class action lawsuit settlements will be funded within our insurance coverage and close in early calendar 2011.

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

- *the impact of competition;*
- *consumer confidence and spending levels;*
- *general economic conditions;*
- *interest and currency exchange rates;*
- *unseasonable weather patterns;*
- *the incidence of illnesses in the general population;*
- *the cost and availability of capital;*
- *the cost and availability of grants/funding;*
- *product development;*
- *lawsuit final settlement expectations within insurance limits;*
- *reliance on third parties;*
- *dependence on a small number of major customers;*
- *hiring expectations and related anticipated capital expenditures;*
- *adequate cash position to mitigate potential tightening of credit terms;*
- *success and adequacy of our long-term strategic objectives;*
- *success and adequacy of the IFRS conversion plan and the impact of the implementation on future financial statements;*
and
- *the risk that actual results may differ from management’s assumptions, estimates and interpretation of policies.*

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.