

Afexa Life Sciences Inc.

Condensed Consolidated Interim Financial Statements (Unaudited)

For the three and six months ended September 30, 2011

Notice of No Auditor Review of Interim Financial Statements

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of Afexa Life Sciences Inc. ("Afexa" or "the Company") have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Afexa Life Sciences Inc.
Condensed Consolidated Interim Statement of Financial Position
(in thousands of Canadian dollars)
(unaudited)

As at	September 30 2011	March 31 2011 restated (note 14)	April 1 2010 restated (note 14)
Assets			
Current			
Cash	\$ 201	\$ 3,691	\$ 17,685
Accounts receivable	5,194	768	998
Inventory (note 6)	13,926	11,956	9,676
Prepaid expenses and deposits	807	470	502
Income taxes receivable	4,595	4,854	239
	24,723	21,739	29,100
Non-current			
Intangible assets	1,241	1,307	1,298
Property and equipment	11,852	12,225	13,004
Deferred tax assets	1,499	965	1,067
Inventory, non-current	-	-	243
	\$ 39,315	\$ 36,236	\$ 44,712
Liabilities			
Current			
Demand operating line of credit (note 7)	\$ 223	\$ -	\$ -
Accounts payable and accruals	12,339	7,822	9,418
Provisions	38	65	113
Customer deposits	2,308	1,628	2,094
Current portion of long-term debt	-	-	710
	14,908	9,515	12,335
Non-current			
Other long-term liabilities	177	287	381
Obligations under finance lease	872	843	789
Deferred revenue	-	-	180
Long-term debt	-	-	4,528
	15,957	10,645	18,213
Shareholders' Equity			
Share capital (note 8)	22,754	22,727	23,011
Contributed surplus	9,768	8,733	8,531
Deficit	(9,164)	(5,869)	(5,043)
	23,358	25,591	26,499
	\$ 39,315	\$ 36,236	\$ 44,712

Commitments (note 12)

Afexa Life Sciences Inc.

Condensed Consolidated Interim Statement of (Loss) Income and Comprehensive (Loss) Income

(in thousands of Canadian dollars except per share amounts)

(unaudited)

	Three months ended		Six months ended	
	2011	September 30 2010 restated (note 14)	2011	September 30 2010 restated (note 14)
Revenue (note 13)	\$ 15,022	\$ 19,232	\$ 19,596	\$ 20,990
Cost of goods sold (note 9)	3,858	5,104	5,540	6,055
	11,164	14,128	14,056	14,935
Operating expenses				
General and administration (note 9)	6,217	2,752	8,791	5,086
Sales and marketing (note 9)	3,144	2,994	5,927	5,308
Research and development (note 9)	1,499	1,608	3,124	3,251
Other expenses (note 9)	1	7	15	13
	10,861	7,361	17,857	13,658
Income (loss) before finance items and income taxes	303	6,767	(3,801)	1,277
Finance items				
Finance costs	64	162	96	242
Finance income	(2)	(11)	(5)	(28)
	62	151	91	214
Income (loss) before income taxes	241	6,616	(3,892)	1,063
Income tax expense (recovery)				
Current	725	1,857	(63)	127
Deferred	(326)	(18)	(534)	269
	399	1,839	(597)	396
Net (loss) income and comprehensive (loss) income	(158)	4,777	(3,295)	667
(Loss) earnings per share				
Basic	\$ (0.00)	\$ 0.05	\$ (0.03)	\$ 0.01
Diluted	\$ (0.00)	\$ 0.05	\$ (0.03)	\$ 0.01
Weighted average number of shares outstanding:				
Basic	103,180,514	104,414,056	103,189,345	104,459,115
Diluted	103,180,514	104,773,204	103,189,345	104,726,077

Afexa Life Sciences Inc.
Interim Consolidated Statement of Changes in Equity
(in thousands of Canadian dollars)
(unaudited)

	Share Capital	Contributed Surplus	Deficit	Total Shareholders' Equity
Balance at April 1, 2010	\$ 23,011	\$ 8,531	\$ (5,043)	\$ 26,499
Net income for the six-month period	-	-	667	667
Share-based compensation related to share options granted	-	303	-	303
Common shares repurchased and cancelled	(55)	(91)	-	(146)
Exercise of options	1	(1)	-	-
Balance at September 30, 2010	<u>\$ 22,957</u>	<u>\$ 8,742</u>	<u>\$ (4,376)</u>	<u>\$ 27,323</u>
Net loss for the six-month period commencing October 1, 2010 and ended March 31, 2011	-	-	(1,493)	(1,493)
Share-based compensation related to share options granted	-	302	-	302
Common shares repurchased and cancelled under the NCIB	(233)	(310)	-	(543)
Exercise of options	3	(1)	-	2
Balance at March 31, 2011	<u>\$ 22,727</u>	<u>\$ 8,733</u>	<u>\$ (5,869)</u>	<u>\$ 25,591</u>
Net loss for the six-month period	-	-	(3,295)	(3,295)
Share-based compensation related to share options granted	-	1,053	-	1,053
Common shares repurchased and cancelled under the NCIB	(7)	(5)	-	(12)
Exercise of options	34	(13)	-	21
Balance at September 30, 2011	<u>\$ 22,754</u>	<u>\$ 9,768</u>	<u>\$ (9,164)</u>	<u>\$ 23,358</u>

Afexa Life Sciences Inc.
Interim Consolidated Statement of Cash Flows
(in thousands of Canadian dollars)
(unaudited)

	Three months ended		Six months ended	
	September 30		September 30	
	2011	2010	2011	2010
Operating activities				
Net (loss) income and comprehensive (loss) income	\$ (158)	\$ 4,777	\$ (3,295)	\$ 667
Items not affecting cash:				
Share-based payments	2,251	307	2,320	458
Deferred income taxes	(326)	(18)	(534)	269
Depreciation and amortization	285	255	567	593
Amortization of lease inducements	(7)	(6)	(13)	(13)
Accreted interest on long-term debt and land under capital lease	14	20	29	43
Loss on disposal of property and equipment	-	-	1	4
Impairment of intangible assets	6	4	15	8
	<u>2,065</u>	<u>5,339</u>	<u>(910)</u>	<u>2,029</u>
Change in non-cash operating working capital	444	(4,199)	(2,705)	(9,739)
Change in deferred revenue	-	(180)	-	(180)
Change in non-current inventory	-	108	-	243
Cash provided by (used in) operating activities	<u>2,509</u>	<u>1,068</u>	<u>(3,615)</u>	<u>(7,647)</u>
Investing activities				
Purchase of property and equipment	(28)	(137)	(48)	(320)
Purchase of intangible assets	(28)	(158)	(59)	(196)
Proceeds on disposal of property and equipment	-	-	-	3
Cash used in investing activities	<u>(56)</u>	<u>(295)</u>	<u>(107)</u>	<u>(513)</u>
Financing activities				
Issuance of share capital	21	1	21	1
Share purchase under normal course issuer bid	-	(146)	(12)	(146)
Repayment of long-term debt	-	(5,014)	-	(5,191)
Cash provided by (used in) financing activities	<u>21</u>	<u>(5,159)</u>	<u>9</u>	<u>(5,336)</u>
Decrease in cash and cash equivalents	2,474	(4,386)	(3,713)	(13,496)
Cash and cash equivalents, beginning of period	(2,496)	8,575	3,691	17,685
Cash and cash equivalents, end of period	\$ (22)	\$ 4,189	\$ (22)	\$ 4,189
Cash and cash equivalents is comprised of:				
Cash	\$ 201	\$ 4,189	\$ 201	\$ 4,189
Demand operating line of credit	(223)	-	(223)	-
	<u>\$ (22)</u>	<u>\$ 4,189</u>	<u>\$ (22)</u>	<u>\$ 4,189</u>
Supplemental cash flow information:				
Interest paid	\$ 64	\$ 162	\$ 96	\$ 242
Interest received	2	11	5	32
Income taxes paid	-	1,410	-	3,256
Income taxes received	515	-	649	1,155
Property and equipment additions				
- included in accounts payable and accruals at period end	43	15	43	15

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

1. Nature of operation

Afexa Life Sciences Inc. is a publicly traded company that develops and sells biopharmaceutical products. The Company has 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, Afexa's 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. Afexa is committed to using a pharmaceutical model (involving rigorous drug discovery and testing methods) to develop natural medicines for health maintenance and disease prevention. Afexa's lead commercial product, COLD-FX[®], is designed to aid in the prevention and relief of colds and flu by strengthening the immune system.

Afexa is incorporated under the Business Corporations Act (Alberta). The Company's common shares are traded on the Toronto Stock Exchange under the symbol FXA. The head office and research centre for the Company is located in Edmonton, Canada. The Company's registered office is 9604-20th Avenue NW, Edmonton, Alberta, Canada, T6N 1G1.

The Company has two wholly owned subsidiary companies. COLD-FX Pharmaceuticals (USA) Inc. is incorporated in the United States, and fX Life Sciences AG is incorporated in Switzerland under the Swiss Code of Obligations.

The consolidated financial statements are not necessarily indicative of results on an annual basis due to seasonal and short-term variations. Revenue from the Company's lead product, COLD-FX, exhibits a seasonal sales pattern tied to the frequency and severity of colds and flu, as well as other factors including weather. This typically results in higher revenue during the quarters ending September 30 and December 31 of each fiscal year compared to the other quarters of the year.

The condensed consolidated interim financial statements ("consolidated financial statements") of the Company for the three and six months ended September 30, 2011 were authorized for issue in accordance with a resolution of the directors on November 11, 2011.

2. Basis of presentation

The consolidated financial statements for the three and six months ended September 30, 2011 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). IFRS has replaced Canadian generally accepted accounting principles ("Canadian GAAP") for publicly accountable enterprises for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these consolidated financial statements ending September 30, 2011.

These consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34 and IFRS 1. Subject to certain transition elections disclosed in note 14, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at April 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 14 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's annual consolidated financial statements for the year ended March 31, 2011. Comparative figures for fiscal 2011 in these consolidated financial statements have been restated to give effect to these changes.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of November 11, 2011. Any subsequent changes to IFRS, that are given effect in the Company's annual consolidated financial statements for the year ending March 31, 2012 could result in restatement of these consolidated financial statements, including the transition adjustments recognized on change over to IFRS.

The consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual consolidated financial statements for the year ended March 31, 2011. Note 14 discloses IFRS information for the three and six months ended September 30, 2010 that is material to an understanding of these consolidated financial statements.

Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis, except for share-based payment arrangements that have been measured at fair value, and land under finance lease and building that have been measured at fair value as deemed cost at the transition date.

The consolidated financial statements are presented in Canadian dollars (\$) and rounded to the nearest thousands of Canadian dollars, except share and per share amounts or where otherwise indicated.

3. Summary of significant accounting policies

Basis of consolidation

These consolidated interim financial statements consolidate the accounts of Afexa and its wholly owned subsidiaries: COLD-FX Pharmaceuticals (USA) Inc. and fX Life Sciences AG.

All intercompany transactions and balances have been eliminated. All companies included in the consolidated financial statements have adopted March 31 as the financial position date and use consistent accounting policies.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Revenue recognition

Revenue from the sale of goods is recognized when all of the following criteria have been met:

- Evidence of a sales arrangement exists;
- Significant risks and rewards of ownership has transferred to the customer, which is generally at the time the goods are delivered;
- Product returns can be reasonably estimated or the right of return has expired;
- The Company retains neither continued managerial involvement nor control over the goods sold;
- The amount of revenue and costs incurred can be reliably measured; and
- Economic benefits associated with the transaction will flow to the Company.

Allowances for estimated returns are made when revenue is recognized. When future returns cannot be reasonably estimated, revenue is not recognized until the risk of return has been substantially eliminated. This risk is substantially eliminated when the final customer purchases the product from the retailer or the right of return has expired or been eliminated. The Company relies on third-party information to estimate when the final customer has completed a purchase. Product shipped where the risk of return cannot be reasonably estimated is included in inventories as product shipped with right of return.

Customer discounts, rebates and incentive allowances, which do not result in a sufficiently separable benefit from the sale, are recorded as a reduction in revenue. If they are separable, they are recorded in either cost of goods sold or in sales and marketing expense, depending on the nature of the expense. For discounts, rebates and incentive allowances to be sufficiently separable from the sale of the goods, the benefit must be identifiable, available from a party other than a purchaser of the Company's products and the fair value must be reasonably estimable.

Customer discounts, rebates and incentive allowances are recognized at the later of the date on which the Company recognizes the related revenue or the date the Company offers the discount, rebate or incentive. If the related revenue is not recognized and the discount is not recoverable in the event of return, the discount is recognized at the later of the date on which the specific activity occurs or the customer recognizes the discount, rebate or incentive allowance.

The Company may also enter into agreements where goods are exchanged for goods or services from vendors. When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods or services are exchanged for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services provided, adjusted by the amount of any cash or cash equivalents transferred.

Cash and cash equivalents

Cash and cash equivalents includes balances with banks, net of outstanding cheques, and the demand operating line of credit.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Inventory

Inventories of raw 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. For product shipped with risk of return, displays and packaging materials normally included in the value of the inventory, which the Company does not expect to recover, are expensed when the product is initially shipped to the customer. 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. Previous write-downs to inventory are reversed when economic changes support an increased net realizable value. Inventory not reasonably expected to be realized in cash during the normal operating cycle is classified as non-current inventory.

Intangible assets

Intangible assets, including patents, registered trademarks, and computer software, are measured on initial recognition at cost and are carried at cost less accumulated amortization and any impairment losses. Patents and registered trademarks are typically considered internally generated assets and computer software is considered acquired from third parties. All intangible assets are considered to have finite useful lives.

Amortization is recognized in earnings from the date that the assets are available for use, as this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Amortization expense on intangible assets is recognized on a straight-line basis over the remaining useful lives of the assets and is recorded in earnings in the expense category consistent with the function of the intangible asset.

Amortization is provided for using the following methods and rates:

Asset Class	Amortization Method
Patents	20 years straight-line
Computer software	3 years straight-line
Registered trademarks	10 years straight-line

The Company periodically reviews the estimated useful lives and carrying values of intangible assets for impairment. Gains or losses arising from the impairment or disposal of individual assets are recognized in earnings in the period of impairment or disposal.

Property and equipment

Property and equipment, including land under finance lease, is measured at cost, or deemed cost (see note 14) less accumulated depreciation. Cost is determined by the amount paid to acquire the property and equipment including any freight and installation costs. Gains and losses arising on the disposal of individual assets are recognized within other expenses in the year disposed.

When components of property and equipment have different useful lives, they are accounted for as separate components of property and equipment.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Depreciation is not recorded until an asset is available for use and is calculated over the depreciable amount, which is the cost of the asset less residual value. The asset's residual value is the estimated amount that the Company would currently obtain from the disposition of the asset, net of estimated disposal costs, if the asset were already at the age and in the condition expected at the end of its useful life.

Depreciation is provided for using the following methods and rates:

Asset Class	Depreciation Method
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 cost for periodic repairs and maintenance are expensed to the extent the expenditures serve only to restore the assets to their normal operating condition without enhancing the service potential or extending their useful lives.

Leases

Leases entered into by the Company in which substantially all of the benefits and risks of ownership are transferred to the Company are recorded as finance leases and classified as property and equipment and obligations under finance lease. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are depreciated over the shorter of the lease term and their useful lives, unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. All other leases are classified as operating leases and leasing costs are expensed in the period in which they are incurred. Lease inducements received by the Company are deferred and depreciated on a straight-line basis over the term of the lease as a reduction in rental expense.

Research and development costs

Research and development costs are charged to expense as incurred, net of related tax credits, unless a development project meets the criteria for capitalization and amortization. Research and development costs include the following direct operating expenditures: salaries and benefits, administration, contracting, consulting and professional fees, and share-based payments. Research and development costs also include an allocation of depreciation and amortization based on utilization of the Company's capital and intangible assets related to research and development activities.

Development costs are capitalized for clearly defined, technically feasible technologies which management intends on producing and promoting to an identified future market with existing or estimated future resources. The Company annually evaluates capitalized development costs to consider whether these costs continue to meet criteria for capitalization. The Company has not capitalized development costs during the periods presented.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Government grants

Government grants received in relation to research activities are recognized at their fair value where there is reasonable assurance Afexa will comply with all attached conditions and will receive the funding. Government grants received for expense items are deducted from the related expense in the period the expense is incurred. For government grants received in relation to expenses of future accounting periods, Afexa recognizes the expense reduction in the period the expense is incurred. Government grants received for capital expenditures are treated as a reduction of the cost of the applicable asset.

Investment tax credits relating to qualifying scientific research and experimental development expenditures that are recoverable in the current period are accounted for as a reduction in research and development expenses or as a reduction in property and equipment depending on the nature of the expenditure. Investment tax credits not recoverable in the current period are accrued provided there is reasonable assurance that the credits will be realized.

Comprehensive income

Comprehensive income is the change in equity (net assets) of the Company, during a period, from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners. The Company does not have other comprehensive income, and accordingly, total comprehensive income and net earnings are equal.

Financial instruments

On acquisition, all financial assets are classified into the following four categories: held-to-maturity, loans and receivables, fair value through profit or loss or available-for-sale. The Company's financial instruments are classified as follows:

- Accounts receivable and cash and cash equivalents as loans and receivables
- Accounts payable and accruals and other long-term liabilities as other liabilities

All financial instruments are initially measured at fair value. Subsequent measurement depends on initial classification.

Loans and receivables

Financial instruments classified as loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade and other receivables are classified as receivables and are initially accounted for at fair value and subsequently adjusted for any allowance for doubtful accounts, with allowances reported in general and administration expenses.

The Company's loans and receivables are presented as current assets or non-current assets depending on their maturity.

Other liabilities

Other liabilities are initially recognized at fair value, net of any transaction costs incurred.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Financial liabilities are classified as current liabilities if payment is due within twelve months. Liabilities that have payments that extend beyond twelve months are considered non-current liabilities.

Transaction costs for demand debt obligations that are directly attributable to the acquisition or issuance of the financial liability are expensed by the Company. Transaction costs for long-term debt obligations are applied against the fair value of the liability when issued and amortized to interest expense using the effective interest rate method.

Impairment of long-lived assets

The Company evaluates the carrying value of long-lived assets, including property and equipment, intangible assets and other assets subject to depreciation or amortization, at the end of each reporting period to determine whether there is any indication of impairment. Factors that the Company considers important which could trigger an impairment include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the asset or the overall strategy of the business, significant negative industry or economic trends, a significant decline in the Company's share price for a sustained period and the Company's market capitalization relative to the net book value of its assets and liabilities.

Intangible assets with indefinite lives and intangible assets that are not yet in use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Impairment of non-monetary long-lived assets is recognized when its carrying amount or cash generating unit ("CGU") exceeds its estimated recoverable amount and is recognized in earnings. The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate. For the purposes of impairment testing, assets that cannot be tested individually are grouped together into a CGU. CGUs are the smallest identifiable group of assets that generate cash inflows and are largely independent of the cash inflows of other assets.

Reversal of impairment costs

Impairment losses recognized in prior periods are assessed at each reporting date for any indicators that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined net of depreciation or amortization, if no impairment loss had been recognized.

Earnings per share

The computation of basic earnings per share has been calculated by dividing net earnings by the weighted average number of common shares outstanding during the period.

Diluted earnings per share reflect the potential dilution that would occur if share options were exercised. The computation of diluted earnings per share has been calculated by dividing net earnings available to common shareholders by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding arising from the exercise of potentially dilutive share options outstanding during the period.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

The Company uses the treasury method for outstanding options which assumes that the use of proceeds that could be obtained upon exercise of options in computing diluted earnings per share are used to purchase the Company's common shares at the average market price during the period. Anti-dilutive amounts are not considered in computing diluted earnings per share.

Income taxes

Income tax expense is comprised of current and deferred tax. Current income tax assets and liabilities for current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. Deferred taxes are determined based on differences between accounting and income tax bases of an asset and liability. Current tax and deferred tax are recognized in profit and loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred tax is not recognized for the following temporary differences: the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that the timing of the reversal of the temporary differences can be controlled and it is probable that they will not reverse in the foreseeable future. Deferred taxes are measured using the substantively enacted tax rates, regulations and laws the Canada, United States, and Swiss tax jurisdictions that are anticipated to be in effect when the differences are expected to reverse.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Share-based payment plans

The Company applies the fair value method of accounting for its share-based payment transactions. The fair value at grant date of share options is estimated using the Black-Scholes option pricing model. Share-based payment expense is recognized over the period that services are rendered. Any consideration paid upon exercise of share options is recorded as an increase in share capital and the recorded fair value of the related share option is reclassified from contributed surplus to share capital.

The Company has 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. Share-based payment expense is recognized as share-based payment on the date of grant as all DSUs vest on the date of grant. Changes in the amount of the liability due to share price changes after the initial grant date are recognized as share-based payments in the period in which the changes occur.

The Company also has a Restricted Share Unit ("RSU") 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

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

the RSU is equal to the share price at the date of grant. In the case of RSUs granted for a prior service period, the compensation cost will be 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 liability is recognized over the period that services are rendered. Changes in the amount of the liability due to share price changes are recognized as share-based payments in the period in which the changes occur.

Provisions

Provisions represent liabilities of the Company for which the amount or timing is uncertain. Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. Provisions are measured at the present value of the expected expenditures to settle the obligation. When the effect of the time value of money is material, provisions are discounted using a discount rate that reflects current market assessment of the time value of money and the risks specific to the obligation.

Translation of foreign currencies

Transactions in currencies other than Afexa's functional currency (Canadian dollars) are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. All gains and losses on foreign currency differences are recognized in profit or loss.

4. Use of estimates and measurement uncertainty

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

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

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

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

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

Revenue recognition

The Company establishes 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 the Company and/or its competitors;
- Analysis of retail sell-through;
- The effect of regulatory changes; and
- The estimated remaining shelf life of products.

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

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

Long-lived assets and impairment

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

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

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Depreciation and amortization

The Company depreciates property and equipment and amortizes intangible assets over the estimated useful lives of the assets. The Company takes into account expectations of the in-service period of these assets in determining these estimates. The Company assesses the estimated useful life of these assets on an annual basis to ensure they match the anticipated life of an asset from a revenue producing perspective. If the Company determines that the useful life of an asset is different from the original assessment, changes to depreciation and amortization will be applied prospectively.

Accrued liabilities

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

Inventory valuation

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

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

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

Share-based payments

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

This fair value estimate also requires determining the most appropriate inputs to the valuation model including the estimated expected life of the share option, volatility, and dividend yield. The expected volatility is based on the historical volatility of the Company's shares over a period commensurate with the expected term of the share option. The risk-free interest rate for the expected life of the option is based

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

on the yield available on government bonds, with an approximate equivalent remaining term at the end of the grant. Historical data is used to estimate the expected life of the option. As well, the Company estimates its forfeiture rate for equity settled transactions based on historical experience in order to determine the compensation expense arising from the share-based awards.

Income taxes

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

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

5. Future accounting standards

IAS 12 Income Taxes — Recovery of Underlying Assets

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

IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements

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

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The completion of this project is expected over the course of 2011. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but will potentially have no impact on classification and measurements of financial liabilities. The Company is currently in the process of evaluating the implications of this new standard.

IFRS 10 Consolidated Financial Statements

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

6. Inventory

Included in cost of goods sold for the three and six months ended September 30, 2011 were write-downs of inventory totalling \$248 and \$472, respectively (three and six months ended September 30, 2010 – \$221 and \$457, respectively). No inventory write-downs recognized in previous periods were reversed in the current period (three and six months ended September 30, 2010 – \$nil).

The Company has pledged inventory as collateral under the terms of the demand operating line of credit (note 7).

7. Demand operating line of credit

Afexa has a credit facility agreement that consists of a demand operating line of credit of \$15,000, with interest at the bank's prime lending rate plus 0.75%. As at September 30, 2011, \$223 was utilized on the line of credit (March 31, 2011 - \$nil). 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 \$6,750 (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 \$4,125. 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 the Company's head office and research facility.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

8. Share capital

(a)

Authorized:

Unlimited number of voting common shares with no par value.

Unlimited number of preferred shares with no par value, voting rights to be determined prior to first issue.

Issued and outstanding:

	Number of shares	Share capital
Voting common shares:		
Balance, April 1, 2010	104,504,670	\$ 23,011
Share repurchase under normal course issuer bid	(1,309,618)	(288)
Exercise of options	7,500	4
Balance, March 31, 2011	103,202,552	22,727
Share repurchase under normal course issuer bid	(30,626)	(7)
Exercise of options	39,000	34
Balance, September 30, 2011	103,210,926	\$ 22,754

On October 14, 2009, the Company received approval from the Toronto Stock Exchange ("TSX") to renew its normal course issuer bid ("NCIB") to repurchase its common shares from the market. Effective October 18, 2010, the Company again renewed its NCIB with the TSX. Under the renewed NCIB, the Company may acquire up to 5,212,941 common shares. The NCIB expired on October 17, 2011 and has not been renewed by the Company.

During the six months ended September 30, 2011, 30,626 common shares, were repurchased (six months ended September 30, 2010 – 247,106) pursuant to the NCIB at a total cost of \$12 or \$0.38 per common share (six months ended September 30, 2010 – \$146 or \$0.59 per common share). All common shares repurchased were cancelled, resulting in a reduction in share capital of \$7 (six months ended September 30, 2010 – \$55) and a reduction in contributed surplus of \$5 (six months ended September 30, 2010 – \$91) representing the consideration in excess of stated capital.

(b) Share option plan

The Company has an incentive share option plan for certain employees, contractors, officers and directors. Upon granting, options were issued over a period that generally extended between four and five years and were settled on an equity basis. Options vested annually in proportion to the number of vesting periods, based on the anniversary date of the options granted. The total number of common shares reserved for issuance under the share option plan shall not exceed 22,170,442. As at September 30, 2011, 6,008,036 (March 31, 2011 – 5,582,036) common shares remain reserved for issuance under the share option plan.

On September 10, 2011, Afexa's Board of Directors resolved to immediately vest all of the Company's unvested share options with an expiration date tied to the tendering of shares pursuant to the Valeant Pharmaceuticals International, Inc. ("Valeant") offer. The tendering of shares occurred October 17, 2011 (see note 15). The expensing of these previously unvested options were immediately recognized and expensed. As the modification reduced the fair value of the share options, measured immediately before and after the modification, the Company measured the amount recognized for share options based on the grant date fair value of the share options granted.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

The continuity of the Company's outstanding and exercisable options is as follows:

	6 months ended September 30, 2011		12 months ended March 31, 2011	
	Number of options outstanding	Weighted average exercise price	Number of options outstanding	Weighted average exercise price
Outstanding, beginning of period	7,105,914	\$ 0.60	5,658,684	\$ 0.78
Exercised	(39,000)	0.53	(7,500)	0.40
Granted	-	-	2,290,980	0.51
Expired, cancelled, and forfeited	(426,000)	0.75	(836,250)	1.54
Outstanding, end of period	6,640,914	\$ 0.60	7,105,914	\$ 0.60
Exercisable, end of period	6,640,914	\$ 0.60	2,143,171	\$ 0.66

The following table summarizes information about share options outstanding and exercisable as at September 30, 2011:

Exercise price	Number outstanding	Weighted average remaining term (in years)	Options vested
\$0.40	930,000	0.1	930,000
\$0.48	600,000	0.1	600,000
\$0.51	1,950,980	0.1	1,950,980
\$0.64	1,056,250	0.1	1,056,250
\$0.68	1,160,000	0.1	1,160,000
\$0.76	698,684	0.1	698,684
\$1.24	220,000	0.1	220,000
\$1.25	25,000	0.1	25,000
	6,640,914		6,640,914

During the three and six months ended September 30, 2011, \$936 and \$1,053, respectively (three and six months ended September 30, 2010 – \$154 and \$303) was recognized as share-based payments related to options with a corresponding increase to contributed surplus.

No options were issued in the six months ended September 30, 2011.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

(c) Deferred share units

	6 months ended September 30 2011	12 months ended March 31 2011
Balance, beginning of period	574,647	251,246
Issued	132,358	323,401
Outstanding and exercisable, end of period	707,005	574,647

During the three and six months ended September 30, 2011, the Company issued DSUs, with fair value of \$37 and \$114, respectively (three and six months ended September 30, 2010 – \$43 and \$87, respectively), and recognized share-based payment expense of \$356 and \$321, respectively (three and six months ended September 30, 2010 - \$79 and \$112, respectively), with a corresponding decrease to accounts payable and accruals. No DSUs were redeemed for the six months ended September 30, 2011. All outstanding DSUs are considered vested at the date of grant. As at September 30, 2011, \$608 (March 31, 2011 – \$287) was recorded in accounts payable and accruals related to the outstanding DSUs.

(d) Restricted share units

	6 months ended September 30 2011	12 months ended March 31 2011
Balance, beginning of period	1,535,439	743,421
Issued	-	792,018
Outstanding, end of period	1,535,439	1,535,439
Exercisable, end of period	569,737	-

On September 10, 2011, Afexa's Board of Directors resolved to vest all unvested RSUs on October 16, 2011.

During the six months ended September 30, 2011, the Company did not issue RSUs (six months ended September 30, 2010 – nil). For the three and six months ended September 30, 2011, the Company recognized share-based payment expense of \$958 and \$946, respectively (three and six months ended September 30, 2010 – \$73 and \$43, respectively), with a corresponding increase to accounts payable and accruals. As at September 30, 2011, the RSUs outstanding had a vesting period of less than one month. As at September 30, 2011, \$1,267 (March 31, 2011 – \$321) was recorded in accounts payable and accruals related to the outstanding RSUs.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

9. Expense by function

6 months ended September 30, 2011	Cost of goods sold	General and administration	Sales and marketing	Research and development	Other expenses
Employee costs	\$ 681	\$ 3,446	\$ 1,873	\$ 1,844	\$ -
Share-based payments	66	1,856	197	201	-
Depreciation	76	98	45	238	-
Amortization	7	14	16	73	-
Other costs	4,627	3,377	3,796	768	15
	\$ 5,457	\$ 8,791	\$ 5,927	\$ 3,124	\$ 15

3 months ended September 30, 2011	Cost of goods sold	General and administration	Sales and marketing	Research and development	Other expenses
Employee costs	\$ 300	\$ 1,832	\$ 764	\$ 790	\$ -
Share-based payments	57	1,842	177	175	-
Depreciation	38	50	23	119	-
Amortization	4	7	8	36	-
Other costs	3,376	2,486	2,172	379	1
	\$ 3,775	\$ 6,217	\$ 3,144	\$ 1,499	\$ 1

6 months ended September 30, 2010	Cost of goods sold	General and administration	Sales and marketing	Research and development	Other expenses
Employee costs	\$ 705	\$ 2,964	\$ 2,025	\$ 1,819	\$ -
Share-based payments	15	314	68	61	-
Depreciation	79	101	48	243	-
Amortization	10	17	20	75	-
Other costs	5,246	1,690	3,147	1,053	13
	\$ 6,055	\$ 5,086	\$ 5,308	\$ 3,251	\$ 13

3 months ended September 30, 2010	Cost of goods sold	General and administration	Sales and marketing	Research and development	Other expenses
Employee costs	\$ 374	\$ 1,654	\$ 1,127	\$ 925	\$ -
Share-based payments	7	238	34	28	-
Depreciation	27	29	24	93	-
Amortization	8	13	16	45	-
Other costs	4,688	818	1,793	517	7
	\$ 5,104	\$ 2,752	\$ 2,994	\$ 1,608	\$ 7

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

10. Related party transactions

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

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

11. Capital disclosures

The Company's objective in managing capital is to safeguard the Company's ability to continue as a going concern so that it can continue to develop and commercialize evidence-based natural health products to increase shareholder value. Capital is defined by the Company as shareholders' equity, long-term debt, and obligations under finance lease and is as follows:

	September 30		March 31		April 1
	2011		2011		2010
Share Capital	\$ 22,754	\$	22,727	\$	23,011
Obligations under finance lease	872		843		789
Current portion of long-term debt	-		-		710
Long-term debt	-		-		4,528
Total capital	\$ 23,626	\$	23,570	\$	29,038

The Company has externally imposed capital requirements as governed through its demand operating line of credit. These requirements are to ensure the Company continues to operate in the normal course of business and to ensure the Company manages its debt relative to tangible net worth. These capital requirements are congruent with the Company's management of capital. The Company met all externally imposed capital requirements at the end of the period.

The Company monitors capital on the basis of the current ratio and debt to tangible net worth ratio which are both financial covenants of the credit facility agreement. The current ratio is calculated as current assets (as shown on the statement of financial position) over current liabilities (as shown on the statement of financial position) and is to be maintained above 1.25:1. As at September 30, 2011, this ratio has decreased to 1.66:1 from the March 31, 2011 ratio of 2.28:1. The decrease in this ratio from March 31, 2011 is largely due to the increase in current liabilities resulting from the Company utilizing the demand operating line of credit and an increase in accounts payable and accruals.

Debt to tangible net worth is calculated as total liabilities (as shown on the statement of financial position) over tangible net worth. Tangible net worth is defined as the sum of share capital, contributed surplus and deficit less intangible assets and deferred tax assets. This ratio is to be maintained below 2.00:1. As at September 30, 2011, this ratio was 0.77:1 (March 31, 2011 – 0.46:1). The increase in this ratio can also be attributed to the Company's increased balance of accounts payable and accruals.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

12. Financial instruments

Fair value of financial instruments

The fair value of financial instruments represents the amounts that would have been received from or paid to counterparties, calculated at the reporting date, to settle these instruments. Cash, trade and other receivables, trade and other payables are financial assets and liabilities that have short periods to maturity and therefore, have carrying values that approximate their estimated fair value.

Management of risks arising from financial instruments

The Company does not use financial derivatives. There has been no change with respect to the Company's overall risk exposure during the period ended September 30, 2011.

Market risk

(a) Interest rate risk

The Company's mortgage was subject to interest rate cash flow risk as the required cash flow to service the debt will 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. The Company entered into a credit facility agreement with a new bank that consists of a demand operating line of credit of \$15,000, with interest at the bank's prime lending rate plus 0.75% (note 7). A change in the interest rate would not materially affect the results of operations or cash flows as the Company had not significantly entered into the demand operating line of credit as at September 30, 2011.

(b) Foreign exchange risk

The Company is currently not exposed to significant foreign currency risk as the assets and liabilities denominated in foreign currencies are minimal.

Credit risk

The maximum exposure to credit risk of the Company as at September 30, 2011 is the carrying value of its financial assets. The Company manages 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.

The Company's 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. The Company performs continuous evaluation of its accounts receivable and records an allowance for doubtful accounts. The failure of a large customer would have a significant effect on the Company. As at September 30, 2011, two customers (March 31, 2011 – two) represented 80% of total accounts receivable (March 31, 2011 – 61%).

Liquidity risk

The Company's 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

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

operations. The Company's 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 the Company's earnings and ability to issue debt and equity instruments as well as its ability to generate liquidity from its statement of financial position (convert assets, for example inventory, to cash).

The Company controls liquidity risk by managing working capital, cash flows and the availability of borrowing facilities. The Company's undiscounted commitments have not changed significantly from March 31, 2011, other than entering into a consulting agreement for strategic and financial advisory services for a total value of \$2,000. As at September 30, 2011, the remaining commitment on this agreement is \$1,885.

The Company has financial assets that are expected to generate sufficient cash inflows to meet cash outflows on financial liabilities.

13. Segmented information

The Company operates in one operating segment - biopharmaceutical products. Management assesses performance and makes resource decisions based on the consolidated results of operations of this operating segment. Substantially all of the operations of the Company are directly engaged in or support this operating segment. Other operations are not material and share many of the same economic and operating characteristics as biopharmaceutical products and, accordingly, they are included with biopharmaceutical products for purposes of segment reporting.

The Company derives significant revenue from certain customers. During the three months ended September 30, 2011, three Canadian customers (three months ended September 30, 2010 - three) accounted for \$11,046 or 74% (three months ended September 30, 2010 - \$13,661 or 71%) of the Company's consolidated revenue. During the six months ended September 30, 2010, three major customers (six months ended September 30, 2010 - three) accounted for \$13,517 or 69% (six months ended September 30, 2010 - \$14,120 or 67%) of the Company's consolidated revenue. Substantially all of the Company's revenue is generated in Canada.

All of the Company's property and equipment is located in Canada.

14. Transition to IFRS

For all periods up to and including March 31, 2011, the Company prepared its financial statements in accordance with Canadian GAAP. Accordingly, the Company has prepared consolidated financial statements that comply with IFRS applicable for periods beginning on or after April 1, 2011, as described in the Company's accounting policies (note 2). The Company prepared its opening statement of financial position as at April 1, 2010, its date of transition to IFRS. The principal adjustments made by the Company in restating its Canadian GAAP statements of financial position as at April 1, 2010, the previously published Canadian GAAP consolidated financial statements for the year ended March 31, 2011 and for the three and six months ended September 30, 2010 are explained within this note.

In preparing these consolidated financial statements in accordance with IFRS 1, the Company has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Elected exemptions from full retrospective application

In preparing these consolidated financial statements, the Company has applied the following optional exemptions from full retrospective application of IFRS provided under IFRS 1 – *First-time Adoption of International Financial Reporting Standards*:

- Cumulative translation differences

The Company has elected to set cumulative translation differences arising from translation of its foreign subsidiaries into the Canadian dollar, to be \$nil at April 1, 2010.

- Share-based payments

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

For its cash-settled share-based payment transactions, or deferred share units and restricted share units, the Company has elected not to retrospectively apply IFRS 2 to any liabilities settled before April 1, 2010.

- Fair value as deemed cost

The Company has elected to measure its land under finance lease and building at their respective fair values as at April 1, 2010 and use those amounts as the assets' deemed cost at that date. For all other property and equipment assets, the Company continues to use the historical cost model.

- Business combinations

The Company will apply the business combinations exemption in IFRS 1 not to apply IFRS 3 – *Business Combinations* retrospectively to past business combinations. Accordingly, Afexa will not restate business combinations that took place prior to April 1, 2010.

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

- Estimates

The Company did not use hindsight to create or revise estimates previously made under Canadian GAAP. The Company's IFRS estimates as of April 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Reconciliation of Canadian GAAP to IFRS

In preparing its opening IFRS statement of financial position, the Company has adjusted the amounts reported previously in consolidated financial statements under Canadian GAAP. An explanation of the effect of transition from Canadian GAAP to IFRS on the Company's financial position and financial performance is set out in the following tables and accompanying notes to those tables. There are no differences between cash flows reported under Canadian GAAP to those reported under IFRS for the three and six months ended September 30, 2010.

Reconciliation of equity as reported under Canadian GAAP to IFRS

		March 31 2011	September 30 2010	April 1 2010
Shareholders' equity, Canadian GAAP	\$	24,794	\$ 26,971	\$ 25,795
IFRS adjustments				
Derecognition of intangible assets		(203)	(303)	(206)
Fair value of building and land under finance lease at deemed cost		634	573	512
Inventory overhead allocation adjustment		-	(455)	-
Current tax adjustment from above noted items		-	131	-
Deferred tax adjustment from above noted items		366	406	398
Total adjustments		797	352	704
Shareholders' equity, IFRS	\$	25,591	\$ 27,323	\$ 26,499

An explanation of the most significant differences between Canadian GAAP and IFRS that impacted opening shareholders' equity are described in further detail below.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Reconciliation of net income and comprehensive income as reported under Canadian GAAP to IFRS

Adjustments impacting comprehensive income

	Notes	3 months ended September 30 2010	6 months ended September 30 2010
Net income and comprehensive income for the period, as reported under Canadian GAAP		\$ 5,124	\$ 1,049
IFRS adjustments			
Derecognition of intangible assets	(i)	(23)	(97)
Fair value of building and land under finance lease at deemed costs	(ii)	30	61
Share-based payment benefits	(iii)	(28)	(31)
Inventory overhead allocation adjustment	(vii)	(455)	(455)
Current tax adjustment from above noted items	(vii)	131	131
Deferred tax adjustment from above noted items	(iv)	(2)	9
		(347)	(382)
Net income and comprehensive income for the period, as reported under IFRS		\$ 4,777	\$ 667

For details on the IFRS adjustments made, see explanations under *Restated statement of comprehensive income*.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

Restated statement of comprehensive income

The following are reconciliations of the net income and comprehensive income previously presented under Canadian GAAP to net income and comprehensive income prepared under IFRS.

for the six months ended September 30, 2010						
Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS transitional adjustments	IFRS balances	IFRS accounts	
Revenue	(iv)	\$ 20,947	\$ 43	\$ 20,990	Revenue	
	(iv)(v)					
Cost of goods sold	(vi)(vii)	5,683	372	6,055	Cost of goods sold	
		15,264	(329)	14,935		
Operating expenses					Operating expenses	
	(i)(iv)					
Sales and marketing	(v)(vi)	4,763	545	5,308	Sales and marketing	
General and administration	(v)(vi)	5,032	54	5,086	General and administration	
Research and development	(v)(vi)	2,541	710	3,251	Research and development	
Amortization	(i)(ii)(v)	688	(688)	-		
Stock-based compensation	(iii)(v)	427	(427)	-		
Loss (gain) on foreign exchange	(v)	1	12	13	Other expenses	
		13,452	206	13,658		
Income before other items and income taxes		1,812	(535)	1,277	Income before finance items and income taxes	
Other items					Finance items	
Interest and bank charges		242		242	Finance costs	
Interest income		(28)		(28)	Finance income	
Impairment of intangible assets	(v)	8	(8)	-		
Other expense	(v)	4	(4)	-		
		226	(12)	214		
Income before income taxes		1,586	(523)	1,063	Income before income taxes	
Income tax (recovery) expense					Income tax (recovery) expense	
Current	(vii)	259	(132)	127	Current	
Future	(i)(ii)	278	(9)	269	Deferred	
		537	(141)	396		
Net income and comprehensive income		\$ 1,049	\$ (382)	\$ 667	Net income and comprehensive income	

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

for the three months ended September 30, 2010

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS transitional adjustments	IFRS balances	IFRS accounts
Revenue	(iv)	\$ 19,189	\$ 43	\$ 19,232	Revenue
	(iv)(v)				
Cost of goods sold	(vi)(vii)	4,695	409	5,104	Cost of goods sold
		14,494	(366)	14,128	
Operating expenses					Operating expenses
	(i)(iv)				
Sales and marketing	(v)(vi)	2,670	324	2,994	Sales and marketing
General and administration	(v)(vi)	2,694	58	2,752	General and administration
Research and development	(v)(vi)	1,295	313	1,608	Research and development
Amortization	(i)(ii)(v)	305	(305)	-	
Stock-based compensation	(iii)(v)	279	(279)	-	
Loss (gain) on foreign exchange	(v)	3	4	7	Other expenses
		7,246	115	7,361	
Income before other items and income taxes		7,248	(481)	6,767	Income before finance items and income taxes
Other items					Finance items
Interest and bank charges		162		162	Finance costs
Interest income		(11)		(11)	Finance income
Impairment of intangible assets	(v)	4	(4)	-	
Other expense	(v)	-		-	
		155	(4)	151	
Income before income taxes		7,093	(477)	6,616	Income before income taxes
Income tax (recovery) expense					Income tax (recovery) expense
Current	(vii)	1,989	(132)	1,857	Current
Future	(i)(ii)	(20)	2	(18)	Deferred
		1,969	(130)	1,839	
Net income and comprehensive income		\$ 5,124	\$ (347)	\$ 4,777	Net income and comprehensive income

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

(i) Afexa's websites were previously capitalized under Canadian GAAP and recorded as intangible assets. SIC 32 does not allow capitalization of Afexa's websites. \$131 in website additions were expensed in the six months ended September 30, 2010 (three months ended September 30, 2010 - \$43), \$34 was reversed for amortization taken under Canadian GAAP related to websites (three months ended September 30, 2010 - \$19).

(ii) The Company elected to measure land under finance lease and building, classified as property and equipment, at fair value as at April 1, 2010 and used that amount as deemed cost as at April 1, 2010. As a result of the decrease in the building's fair value, the Company's depreciation expense decreased by \$61 for the six months ended September 30, 2010 (three months ended September 30, 2010 - \$31).

(iii) Under Canadian GAAP, the Company calculated the fair value of share-based awards as one grant recognizing the fair value on a straight-line basis over the entire vesting period. As well, forfeitures of awards were recognized as they occurred. IFRS 2 requires that awards with multiple vesting dates are graded with each vesting period treated as a separate tranche. The fair value of each tranche is then calculated separately and is amortized over the vesting period of the respective tranches. Also, award forfeitures are estimated as part of share-based payments. The change in treatment of share-based awards has resulted in an increase of \$31 to contributed surplus for the six months ended September 30, 2010 (three months ended September 30, 2010 - \$28).

(iv) When goods or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue under IAS 18. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services provided, adjusted by the amount of any cash or cash equivalents transferred. There was no such requirement under Canadian GAAP to recognize revenue when such an exchange occurred. As a result, for the three and six months ended September 30, 2010, the Company has recorded increased revenue of \$43, increased cost of goods sold of \$8, and additional sales and marketing expenses of \$35 for goods that were exchanged for services.

(v) Under Canadian GAAP, the Company presented revenue and expenses by function, with the exception of depreciation of property and equipment and amortization of intangible assets as well as share-based payments. Under IAS 1, the Company continues to group revenue and expenses by function. However, depreciation, amortization and share-based payments are no longer presented separately, but allocated based on function and included as part of cost of goods sold, sales and marketing, general and administration, and research and development expenses.

Additionally, gain or loss on foreign exchange, impairment of intangible assets and other expenses are now reported in aggregate as other expenses.

(vi) Certain expense items in the three and six months ended September 30, 2010 have been reclassified from the Canadian GAAP presentation to other expense lines within the consolidated statement of loss and comprehensive loss. The reclassification was made to better align the presentation of expenses in the three and six months ended September 30, 2010 to the annual consolidated statement of loss and comprehensive loss for the year ended March 31, 2011. The expense items affected were cost of goods sold, sales and marketing, general and administration, and research and development. There is no net impact to the net income and comprehensive net income for the period.

Afexa Life Sciences Inc.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

Three and six months ended September 30, 2011

All amounts are in thousands of Canadian dollars, except share and per share amounts

(vii) Interim reporting under IAS 34 specifies that price, efficiency, spending, and volume variances recognized in earnings at interim reporting dates to the same extent that those variances are recognized in income at financial year end. Deferral of variances that are expected to be absorbed by year end is not appropriate because it could result in reporting inventory at the interim date at more or less than its portion of the actual cost to manufacture. As such, an additional \$455 has been recognized for the three and six months ended September 30, 2010 for previously unrecognized inventory variances at the interim period.

15. Subsequent events

On October 18, 2011, Afexa was advised by 1625907 Alberta Ltd. (the "Offeror"), a wholly-owned subsidiary of Valeant Pharmaceuticals, Inc. ("Valeant"), that 80,929,921 common shares ("Common Shares") of Afexa were deposited to the Offeror's offer (the "Valeant Offer") dated October 3, 2011 to acquire all of the issued and outstanding Common Shares and that all such Common Shares have been taken up and will be paid for in accordance with the terms of the Valeant Offer. The Common Shares taken up under the Valeant Offer represent approximately 73.8% of the issued and outstanding Common Shares (on a fully-diluted basis).

On October 27, 2011, Afexa was advised that 8,523,517 Common Shares were deposited to the Valeant Offer and that all such Common Shares have been taken up and will be paid for in accordance with the terms of the Valeant Offer. Together with the Common Shares previously taken up on October 17, 2011, the Common Shares taken up under the Valeant Offer represent approximately 81.6% of the issued and outstanding Common Shares (on a fully-diluted basis).

Afexa's shareholders who tendered to the Valeant Offer received \$0.85 per share in cash which were paid to Afexa's shareholders in accordance with the terms of the Valeant Offer.

Valeant also announced that the votes attached to the Common Shares held by the Offeror are sufficient to approve a subsequent acquisition transaction which will result in the privatization of Afexa and the remaining shareholders of Afexa receiving \$0.85 per Common Share.

The Offeror has advised Afexa that the Valeant Offer will not be further extended and that it will vote its Common Shares in favour of the approval of the subsequent acquisition transaction at the December 12, 2011 special meeting of Afexa shareholders. Following the approval of the subsequent acquisition, Afexa's Common Shares will be delisted from the Toronto Stock Exchange and application will be made to the relevant securities regulatory authorities for Afexa to cease to be a reporting issuer. Afexa has filed a notice on SEDAR for the special shareholder meeting to be held on December 12, 2011.