IMPROVE
INNOVATE
TRANSFORM

IMPROVE. INNOVATE. TRANSFORM.

THAT IS AT THE HEART OF WHAT WE DO AT CIPHER.

With Lipofen®, we have **IMPROVED** the absorption profile of the popular cholesterol medication, fenofibrate.

With our formulation of the increasingly prescribed pain medication tramadol, we have **INNOVATED**—creating an extended-release version that we believe has a best-in-class profile, offering rapid absorption and no food effect.

And with our formulation of isotretinoin for the treatment of severe acne, we have developed a product that has a best-in-class profile and we expect it will be the first reformulation of its kind in the United States. The market opportunity for this product has the potential to **TRANSFORM** the future financial performance of the company.

ADVANCING CURRENT PRODUCTS.

In 2010, we made important progress with each of our products. The net result is we have greatly improved the outlook for Cipher. Our first product is generating steady royalties. We have a second product approved by the FDA and poised for commercialization. Our highest-potential product, CIP-ISOTRETINOIN, is just about through its final pivotal Phase III study. And our financial results have strengthened, providing the foundation for sustainable growth.

LIPOFEN®

(fenofibrate capsules)

Indication:
Hyperlipidemia

U.S. Market size:
US$2 billion

DIFFERENTIATION / BENEFIT	2010 HIGHLIGHTS
A unique dosage form providing enhanced absorption under high vs. low fat fed conditions.	Total royalties from Lipofen® increased 64% over 2009.

WHAT'S NEXT?

While we continue to generate royalties from U.S. sales, we are evaluating out-licensing opportunities for the product in other regions.

CIP-TRAMADOL ER

Indication:
Moderate to moderately severe chronic pain

U.S. Market size:
US$200 million
(extended release only)

DIFFERENTIATION / BENEFIT	2010 HIGHLIGHTS
In addition to once-daily dosing, the product has rapid absorption and no food effect relative to other once-daily formulations.	Received final FDA approval in May 2010. U.S. and Canadian patent applications were allowed, providing important intellectual property protection.

WHAT'S NEXT?

We are currently preparing for the U.S. commercial launch, which includes securing a marketing partner and finalizing commercial manufacturing requirements.

We are also evaluating out-licensing opportunities for the product in other regions.

CIP-ISOTRETINOIN

Indication:
Severe acne

U.S. Market size:
US$800 million

DIFFERENTIATION / BENEFIT	2010 HIGHLIGHTS
More consistent absorption enabling the patient to reach their targeted cumulative dose over the treatment period.	Completed patient enrolment in Phase III safety study. Achieved US$3.0 million in trial-related milestones.

WHAT'S NEXT?

We expect to complete the Phase III safety study in Q2 2011, publish top-line results in Q3 2011, and complete the FDA and Health Canada submission in Q4 2011.

In addition, we are evaluating out-licensing opportunities for the product in other regions.

LETTER TO SHAREHOLDERS

Overall, we were pleased with the Company's performance in 2010. We reached important milestones with each of our three products and delivered improved financial results.

During 2010, we saw growth in royalty revenue from Lipofen as our U.S. distributor, Kowa Pharmaceuticals America, continued its penetration of primary care physicians in its targeted regions and expanded its sales force to approximately 250. Total royalties from Lipofen increased 64% over 2009. Kowa launched a second product in 2010, moving Lipofen to a second position in physician detailing time. This had a predictable near-term impact on the growth of new Lipofen prescriptions in the second half of 2010, as a significant amount of sales rep effort was on getting this new product off the ground. A contractual increase in our royalty payments and a product price increase during the year helped to offset reduced promotional effort. We are hopeful we will see prescriptions remain strong throughout 2011.

Looking at our extended-release tramadol, 2010 saw us achieve final U.S. Food and Drug Administration (FDA) approval and receive Patent Notice of Allowances in both the U.S. and Canada, providing important intellectual property protection as we prepare to launch the product. Our U.S. patent was issued and is now listed in the Orange Book. We are currently taking a number of steps in preparation for the U.S. commercial launch. Galephar, our manufacturing partner, has produced the required commercial validation batches. We had a trade name approved by the FDA in late 2010 and final packaging is planned for Q2 2011. We continue to have very active discussions with prospective out-licensing partners. While the U.S. tramadol market has its challenges, there is clearly need for the drug, as evidenced by the continued growth in total tramadol prescriptions. We believe that our product, with its best-in-class attributes, remains a very attractive asset for a U.S. distributor.

Looking at CIP-ISOTRETINOIN, we continued to make excellent progress with the pivotal Phase III safety study, completing patient enrollment in Q4 2010. This is the largest, most comprehensive trial conducted on isotretinoin and we are pleased that the clinical investigators working with our internal team met this important clinical milestone on target. We expect to publish top line results in early Q3 2011 and complete the FDA submission in Q4 2011. The FDA review is expected to take approximately six months.

In 2010, higher royalties from Lipofen helped drive a substantial increase in revenue. Net revenue in 2010 was $5.4 million, up 70% from $3.2 million in 2009. Revenue from Lipofen totaled $5.0 million, an increase of $2.1 million over 2009. The combination of higher revenues and reduced costs enabled the Company to achieve profitability and strengthen our cash balance. Net income for 2010 increased to $0.1 million compared with a net loss of $2.7 million in 2009. At year-end, our balance sheet showed cash of $10.3 million, compared with $9.0 million as at December 31, 2009, and no debt. With continued royalties from Lipofen® and additional milestones on our other two products this year, we are confident in our financial position.

As we head into 2011, we are focused on several key priorities, including securing a marketing partner and commercializing our extended-release tramadol in the U.S. market; submitting the results of the CIP-ISOTRETINOIN Phase III safety study; and evaluating opportunities both to broaden our product portfolio and out-license our current products in other markets.

We look forward to updating you on our progress during the year.

Sincerely,

Larry Andrews
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2010

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") for the year ended December 31, 2010. This document should be read in conjunction with the audited financial statements and the accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles. Additional information about the Company, including the annual financial statements and Annual Information Form for the year ended December 31, 2010, is available on SEDAR at www.sedar.com.

The discussion and analysis within this MD&A are as of March 8, 2011.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This document includes forward-looking statements within the meaning of certain securities laws, including the "safe harbour" provisions of the Securities Act (Ontario) and other provincial securities law in Canada. These forward-looking statements include, among others, statements with respect to our objectives, goals and strategies to achieve those objectives and goals, as well as statements with respect to our beliefs, plans, objectives, expectations, anticipations, estimates and intentions. The words "may", "will", "could", "should", "would", "suspect", "outlook", "believe", "plan", "anticipate", "estimate", "expect", "intend", "forecast", "objective", "hope" and "continue" (or the negative thereof), and words and expressions of similar import, are intended to identify forward-looking statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, which give rise to the possibility that predictions, forecasts, projections and other forward-looking statements will not be achieved. Certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from those expressed or implied in such statements. We caution readers not to place undue reliance on these statements as a number of important factors, many of which are beyond our control, could cause our actual results to differ materially from the beliefs, plans, objectives, expectations, anticipations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the applicability of patents and proprietary technology; possible patent litigation; regulatory approval of products in the Company's pipeline; changes in government regulation or regulatory approval processes; government and third-party payer reimbursement; dependence on strategic partnerships for product candidates and technologies, marketing and research and development ("R&D") services; meeting projected drug development timelines and goals; intensifying competition; rapid technological change in the pharmaceutical industry; anticipated future losses; the ability to access capital to fund R&D; and the ability to attract and retain key personnel.

We caution that the foregoing list of important factors that may affect future results is not exhaustive. When reviewing our forward-looking statements, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Additional information about factors that may cause actual results to differ materially from expectations, and about material factors or assumptions applied in making forward-looking statements, may be found in the "Risk Factors" section of our Annual Information Form, under "Business Risks" and elsewhere in the following Management's Discussion and Analysis of Operating Results and Financial Position and elsewhere in our filings with Canadian securities regulators. Except as required by Canadian securities law, we do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by us or on our behalf; such statements speak only as of the date made. The forward-looking statements included herein are expressly qualified in their entirety by this cautionary language.

OVERVIEW

Cipher is a drug development company focused on commercializing novel formulations of successful, currently marketed molecules using advanced drug delivery technologies. Cipher's strategy is to in-license products that incorporate innovative drug delivery technologies and advance them through the clinical development and regulatory approval stages, after which the products will be out-licensed to international partners. Because Cipher's products are based on proven technology platforms applied to currently marketed drugs, they are expected to have lower approval risk, shorter development timelines and significantly lower development costs.

The Company seeks to create relationships with partners that provide both proven technology and manufacturing capabilities. Cipher believes that its internal clinical and regulatory capabilities combined with the proven technology and manufacturing strength of its intended partners will result in successful commercial products and will allow the Company to manage the risks associated with the drug development industry. The Company's regulatory strategy is to take the more rapid U.S. Food and Drug Administration ("FDA") 505(b)(2) approach to achieving approval for a New Drug Application ("NDA"). This approach allows the Company to rely on the significant amount of efficacy and safety data already filed with the FDA, thereby reducing the amount of new pre-clinical and clinical data required.

CIP-FENOFIBRATE has been approved in the U.S. and Canada under the trademarks Lipofen® and Fenomax™, respectively. CIP-TRAMADOL ER has also received final approval from the FDA. CIP-ISOTRETINOIN's application has been filed and is pending FDA approval subject to successful completion of a safety study.

CIP-FENOFIBRATE is a novel patented formulation of the active ingredient fenofibrate, which is used in the treatment of hyperlipidemia, a cholesterol disorder. Hyperlipidemia is a condition characterized by high levels of low-density lipoprotein ("LDL") cholesterol and/or triglycerides (a type of fat found in the blood). Fenofibrate is known to lower LDL cholesterol and triglycerides and increase high-density lipoproteins ("HDL"), known as "good cholesterol". Fibrates have proven to be superior in lowering triglycerides and raising HDL levels. CIP-FENOFIBRATE targets a large and growing market. According to IMS, the hyperlipidemia market in the U.S. alone exceeds US$19 billion and is made up of three primary groups of drugs: statins, fibrates and the prescription DHA/EPA (omega 3) market. The use of fenofibrates has escalated rapidly in recent years. The market for existing fenofibrate formulations in the U.S. exceeded US$2 billion during 2010, with prescriptions growing 6.4% over the previous year.

CIP-ISOTRETINOIN is an innovative formulation of the active ingredient isotretinoin, which is used in the treatment of severe acne. CIP-ISOTRETINOIN, which is based on the same oral Lidose® drug delivery system used with CIP-FENOFIBRATE, has been in-licensed from Galephar Pharmaceutical Research Inc. ("Galephar"). The Company's marketing rights to CIP-ISOTRETINOIN include the Americas and a majority of the Pacific Rim. In Phase I clinical studies, Cipher's innovative formulation demonstrated a significant competitive advantage in the treatment of severe, recalcitrant nodular acne. CIP-ISOTRETINOIN provides more consistent absorption under fed and fasted conditions, compared with existing isotretinoin products that exhibit a 65% reduction in absorption under fasted conditions. According to IMS, the U.S. isotretinoin market was almost half a billion dollars in 2010, and if converted into brand dollars, is estimated to be almost US$0.8 billion in annual sales. Cipher was issued a product patent from the United States Patent and Trademark Office in the fourth quarter of 2008. The patent includes claims related to the reduced food effect of CIP-ISOTRETINOIN relative to currently marketed formulations.

CIP-TRAMADOL ER is a novel, biphasic, extended-release formulation of the active ingredient tramadol, which is used for the management of moderate to moderately severe pain. CIP-TRAMADOL ER is enabled by oral controlled-release beads, a drug delivery technology licensed from Galephar. The novel formulation means that CIP-TRAMADOL ER delivers extended-

release drug delivery properties, with once-daily dosing, supporting ease-of-use for physicians and a high level of compliance among chronic pain sufferers. Until recently, pain sufferers typically required three to five doses of tramadol per day. While Cipher is one of three companies with a once-daily dose targeting the U.S. market, the Company believes there is sufficient opportunity in the pain relief market for its tramadol capsule, due to the size of the market and CIP-TRAMADOL ER's unique attributes. According to IMS, the U.S. market for extended release formulations of tramadol exceeded $0.15 billion which only represents 3.4% of the total tramadol immediate release and extended release prescription market. The total tramadol market exceeded 30 million prescriptions in 2010 with an annual growth rate in prescriptions of 8%.

PRODUCT UPDATE

CIP-FENOFIBRATE

CIP-FENOFIBRATE is the first product from the current pipeline to successfully receive approval from the FDA and the Therapeutic Products Directorate ("TPD") of Health Canada. The primary target market for the product is the United States.

Cipher's U.S. marketing and distribution partner is Kowa Pharmaceuticals America, Inc. ("Kowa"). The agreement with Kowa is for a period of ten years and they have the right to extend the term for two additional two-year periods. Under the agreement, Cipher received a US$2 million up-front payment and in 2010 a cumulative net sales milestone was achieved, which resulted in a US$1 million payment to Cipher. The Company could receive additional milestone payments of up to US$19 million if certain future net sales targets are achieved. Cipher also receives a royalty on a percentage of net sales, which escalates from the mid-teens to mid-twenties based on annual sales achieved and the level of promotional effort by Kowa. These receipts, along with mark-ups on cost of goods sold, are reflected in Cipher's net revenue, which also incorporate direct product-related expenses and amounts due to Galephar, Cipher's technology partner. After product-related expenses are deducted, approximately 50% of all net revenue received by Cipher under the agreement will be paid to Galephar.

Lipofen was launched in the U.S. market in late 2007 and monthly prescriptions have shown steady growth since that time as Kowa increases coverage of the primary care physicians in its targeted regions and expands its sales force. Kowa's sales force has grown to approximately 250 to support the Q3 2010 launch of their complementary product, Livalo (pitavastatin). Since Q3 2010, Lipofen has been detailed in second position (after Livalo) to U.S. physicians. During Q4 2010, Lipofen® total monthly prescriptions in the U.S. market remained strong.

CIP-ISOTRETINOIN

In August 2008, the Company achieved a major milestone with the completion of a distribution and supply agreement with Ranbaxy Pharmaceuticals Inc. ("RPI"), a wholly owned subsidiary of Ranbaxy Laboratories Limited, under which Cipher granted RPI the exclusive right to market, sell and distribute CIP-ISOTRETINOIN in the United States.

Under the terms of the agreement with RPI, Cipher received an upfront payment of US$1 million and in Q2 2010 achieved a US$2 million milestone for reaching the mid-point of the enrolment period for the trial. Another trial-related milestone was achieved in Q4 2010 that resulted in the receipt of an additional US$1 million. The agreement provides for additional pre- and post-commercialization milestone payments of up to US$20 million, contingent upon the achievement of certain future milestone targets. Once the product is successfully commercialized, Cipher will also receive a royalty percentage in the mid-teens on net sales. RPI has agreed to reimburse Cipher for the costs associated with the clinical studies required to obtain FDA approval, up to a predetermined cap. Any additional development costs associated with initial FDA approval will be shared equally. The Company expects that the cap amount will be exceeded in 2011 and Cipher's share of the excess costs will be recorded as research and development expenses.

Cipher is responsible for all product development activities, including management of the clinical studies required to secure NDA approval. Cipher is also responsible for product supply and manufacturing, which would be fulfilled by its partner, Galephar.

Cipher is currently conducting a pivotal Phase III safety trial for the product. The study is being conducted under an FDA Special Protocol Assessment ("SPA") and is expected to be completed over an 18-month period at 50 sites in the U.S. and Canada. The study is a randomized double-blinded trial comparing the safety profile of CIP-ISOTRETINOIN to an FDA-approved, commercially available isotretinoin product. The study began early in the fourth quarter of 2009. During Q4 2010, the Company completed patient enrolment. A total of 934 patients were enrolled and 61 patients are still in the process of completing the study. A trial-related milestone achieved in Q4 2010 resulted in the receipt of a US$1 million payment from RPI. Cipher expects to complete the study in early Q2 2011, publish top-line results in early Q3 2011, and complete its FDA submission in Q4 2011. The FDA review is expected to take six months.

CIP-TRAMADOL ER

In May 2010, Cipher announced that the FDA had approved CIP-TRAMADOL ER, the Company's extended-release tramadol product, for the treatment of moderate to moderately severe chronic pain in adults. Also during Q2 2010, the United States Court of Appeals upheld the lower court's original decision on patent infringement litigation initiated by Purdue against Par Pharmaceutical Companies, Inc. relating to Ultram® ER, the reference product in Cipher's New Drug Application for CIP-TRAMADOL ER. This decision further mitigates any remaining risk of litigation on these patents against CIP-TRAMADOL ER.

During Q4 2010, the U.S. Patent and Trademark Office issued a patent for CIP-TRAMADOL ER. Also during Q4, the Company received a Patent Notice of Allowance from the Canadian Intellectual Property Office and the patent is expected to be issued in early 2011. Cipher is currently preparing for the U.S. commercial launch of the product, which includes securing a marketing partner and finalizing commercial manufacturing requirements. The Company is targeting late second quarter of 2011 for commercial launch.

NEW PRODUCTS AND OUT-LICENSING ACTIVITIES

Cipher continues to actively pursue new early stage pipeline product candidates and advance out-licensing discussion for its current products in other territories.

SELECTED ANNUAL INFORMATION

The following information has been prepared under Canadian generally accepted accounting principles in Canadian dollars.

Financial Information (in thousands of dollars, except per share amounts):

For the years ended December 31,

	2010	2009	2008
Licensing revenue	5,385	3,179	1,543
Net income (loss)	56	(2,715)	(3,230)
Basic and diluted income (loss) per share	0.00	(0.11)	(0.13)
Total assets	16,173	14,823	16,377

REVIEW OF OPERATING RESULTS

Revenues (in thousands of dollars):

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Licensing revenue	5,385	3,179	2,206	70

For the quarter ended December 31, 2010 the Company recorded licensing revenue of $1.2 million compared to $0.8 million in Q4 2009. Total revenue in 2010 was $5.4 million, a 70% increase over the $3.2 million recorded in 2009. The increase reflects the continued market penetration of Lipofen as Kowa continues the sales and promotion effort behind the product as well as the increase in the royalty percentage starting in Q3 2010 when the product moved into second promotional position.

Revenue from Lipofen in 2010 totalled $5.0 million, an increase of $2.1 million over 2009. The increase in revenue was primarily a result of increased Lipofen royalty revenues and a US$1 million milestone in Q2 2010 for the achievement of a cumulative net sales milestone level.

Revenue from CIP-ISOTRETINOIN was $0.4 million in 2010 ($0.3 million in 2009), which relates to revenue recognized on the Company's share of the three milestones received to date.

Licensing revenue is presented on a net basis and reflects the various elements of the agreements with distribution partners, as well as amounts due to Galephar, the Company's technology partner.

Research and Development Expense (in thousands of dollars):

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Research and development	743	956	(213)	(22)

Research and development ("R&D") expense represents the cost of the Company's drug development activities. Reported R&D expense is shown net of the amounts reimbursed for the CIP-ISOTRETINOIN Phase III clinical study and refundable provincial tax credits. Gross R&D expenditures during Q4 2010 were $2.3 million, which represents a decrease of $0.7 million compared to Q4 2009. The reported amount of nil for Q4 2010 is net of $2.3 million of reimbursed R&D costs related to the CIP-ISOTRETINOIN Phase III clinical study and the impact of R&D refundable tax credits recorded in the quarter. In Q4 2009, $2.7 million of gross R&D expenditures were incurred for the CIP-ISOTRETINOIN clinical study.

Gross R&D expenditures for 2010 were $12.8 million, an increase of $7.4 million compared to 2009. The reported R&D expense of $0.7 million, which is net of the reimbursement of $11.8 million related to the CIP-ISOTRETINOIN Phase III clinical study and refundable provincial tax credits of $0.3 million, decreased by $0.2 million compared to 2009, reflecting the advanced stage of development of the Company's current products.

The amount of future R&D spending will depend on additional clinical development requirements for the Company's current products and on development plans for any new products in-licensed by the Company.

Operating, General and Administrative Expense ("OG&A") (in thousands of dollars):

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Operating, general & administrative	3,895	4,252	(357)	(8)

OG&A expense in Q4 2010 was $0.9 million compared to $1.1 million in the fourth quarter of 2009. For the year ended December 31, 2010, OG&A expense was $3.9 million, a decrease of $0.4 million, or 8%, compared to 2009.

Amortization of Intangible Assets (in thousands of dollars):

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Amortization of intangible assets	704	741	(37)	(5)

The Company began amortizing the intangible rights associated with CIP-ISOTRETINOIN in the first quarter of 2009. The Company began amortizing the intangible rights related to CIP-FENOFIBRATE in January 2006 and the full value of that intangible asset was amortized by the end of 2010.

Intangible assets have a finite life and are amortized using the straight-line method over their estimated period of useful life. Intangible assets are reviewed for impairment when events or other changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

Interest Income (in thousands of dollars):

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Interest income	66	124	(58)	(47)

Interest is earned on the Company's cash balance and, until the end of 2009, imputed interest was earned on the loan receivable. The reduction in interest income in 2010 compared to 2009 was a result of there being no imputed interest income in the current year.

Provision for Income Taxes:

The Company has approximately $23 million of future income tax assets, for which a valuation allowance has been recorded against the entire balance. These assets consist of non-capital loss carry forwards, intangible assets and R&D expenditures which are available to reduce taxable income in future years. The Company also has approximately $3.5 million of investment tax credits on scientific research and experimental development expenditures which are available to be applied against federal taxes otherwise payable in future years.

Income (loss) per Share:

For the years ended December 31,

	2010	2009	$ change in 2010	% change in 2010
Income (loss) (in thousands of dollars)	56	(2,715)	2,771	nm
Basic and diluted earnings (loss) per share	0.00	(0.11)	0.11	nm

Earnings per share is calculated using the weighted average number of shares outstanding. In 2010, Cipher achieved positive annual net income for the first time in its corporate history as a result of the Company's growing revenue base and reduced operating expenses. Net income in Q4 2010 was $0.1 million, or $0.00 per share, compared with a loss of $0.6 million, or $0.03 per share, for the quarter ended December 31, 2009. Net income for the year ended December 31, 2010 was $0.1 million, or $0.00 per share, compared with a loss of $2.7 million, or $0.11 per share, in 2009. The improved performance in 2010 was primarily a result of increased revenue generated from Lipofen combined with reduced R&D and OG&A expenses during the year.

SUMMARY OF QUARTERLY RESULTS

Quarterly Statements of Income (in thousands of dollars, except per share amounts):

For the year ended December 31, 2010

	Q1	Q2	Q3	Q4	2010 Total
Licensing revenue	918	2,218	1,081	1,168	5,385
Research & development (1)	278	245	220	0	743
Operating, general and administrative	968	1,052	955	920	3,895
Depreciation of property and equipment	14	14	12	13	53
Amortization of intangible assets	176	176	176	176	704
Interest income	6	12	22	26	66
Net Income (loss)	(512)	743	(260)	85	56
Earnings (loss) per share	(0.02)	0.03	(0.01)	0.00	0.00

(1) Reported R&D expense for 2010 is net of provincial tax credits of $328 and reimbursements from Ranbaxy for R&D costs for CIP-ISOTRETINOIN of $11,764

For the year ended December 31, 2009

	Q1	Q2	Q3	Q4	2009 Total
Licensing revenue	602	678	1,067	832	3,179
Research & development (2)	229	225	247	255	956
Operating, general and administrative	989	1,057	1,157	1,049	4,252
Depreciation of property and equipment	19	18	19	13	69
Amortization of intangible assets	188	189	188	176	741
Interest income	46	27	26	25	124
Net Income (loss)	(777)	(784)	(518)	(636)	(2,715)
Earnings (loss) per share	(0.03)	(0.03)	(0.02)	(0.03)	(0.11)

(2) Reported R&D expense for 2009 is net of provincial tax credits of $53 and reimbursements from Ranbaxy for R&D costs for CIP-ISOTRETINOIN of $4,372

For the year ended December 31, 2008

	Q1	Q2	Q3	Q4	2008 Total
Licensing revenue	177	277	672	417	1,543
Research & development (3)	450	1,092	(220)	(19)	1,303
Operating, general and administrative	811	967	879	908	3,565
Depreciation of property and equipment	17	18	18	18	71
Amortization of intangible assets	117	116	117	116	466
Recovery of legal fees and court costs	0	0	176	0	176
Interest income	138	113	119	86	456
Net Income (loss)	(1,080)	(1,803)	173	(520)	(3,230)
Earnings (loss) per share	(0.04)	(0.08)	0.01	(0.02)	(0.13)

(3) Reported R&D expense for 2008 is net of provincial tax credits of $440 and reimbursements from Ranbaxy for R&D costs for CIP-ISOTRETINOIN of $496

LIQUIDITY AND CAPITAL RESOURCES

The cash balance at December 31, 2010 was $10.3 million, compared to $9.0 million as at December 31, 2009. The Company expects that these funds, as well as revenues generated from licensing and distribution agreements (royalties and milestone payments), will be sufficient to fund current product development and operating costs.

The balance of accounts receivable was $1.8 million at December 31, 2010, compared to $1.0 million as at December 31, 2009. The increase is in line with the higher level of commercial activity during the year.

The balance of accounts payable and accrued liabilities was $2.4 million at December 31, 2010 compared to $1.6 million as at December 31, 2009. The increase is in line with the higher level of commercial activity during the year.

Deferred revenue relates to amounts received in advance of recognition as revenue. The balance of $2.3 million at December 31, 2010 relates to the up-front licensing payment and pre-commercialization milestone payments received by Cipher under the CIP-ISOTRETINOIN distribution and supply agreement, net of revenue recognized to date. The deferred revenue balance at December 31, 2009 was $2.3 million.

The development of pharmaceutical products is a process that requires significant investment. While the Company was profitable in 2010, to further its growth strategy Cipher may incur losses from operations going forward, depending mainly on the level of investment in new product/pipeline development.

Future cash requirements will depend on a number of factors, including the continued progress of R&D for product candidates, the timing and outcome of clinical trials and regulatory approvals, the ability to out-license approved products to distributors, the timing of payments received or made under licensing or other collaborative agreements, the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims and other intellectual property rights, defending against patent infringement claims, the acquisition of licenses for new products or technologies, the status of competitive products and the success of the Company in developing and maintaining markets for its products and services.

As at December 31, 2010, there are no capital lease contractual obligations. The only significant operating lease contractual obligation is the Company's office location, which expires in 2012.

SHARE CAPITAL

The Company is authorized to issue an unlimited number of preference shares, issuable in series, and an unlimited number of voting common shares. At December 31, 2010, and at the date of this MD&A, the Company had 24,079,878 common shares issued and outstanding.

A total of 221,500 stock options were issued during 2010, with an exercise price of $1.60. During the year, 25,000 shares were issued as a result of the exercise of stock options.

Stock-based compensation expense in 2010 was $0.4 million, compared to $0.7 million in 2009.

CRITICAL ACCOUNTING ESTIMATES

A summary of significant accounting policies is included in Note 1 of the Notes to Financial Statements for the year ended December 31, 2010. Critical accounting estimates require management to make certain judgments and estimates, which may differ from actual results. Accounting estimates are based on historical experience and other factors that management believes to be reasonable under the time frame and circumstances. Changes in management's

accounting estimates can have a material impact on the financial results of the Company. The Company's critical accounting estimates are described below.

Intangible Assets: Management is required to estimate the recoverability of the Company's intangible assets to assess if there has been an impairment. The accounting estimates and assumptions used to determine the recoverability of these intangible assets may differ from actual results. Changes in these estimates and assumptions can have a material impact on the intangible asset balance in the financial statements.

Income Taxes: Management uses estimates when determining current and future income taxes. These estimates are used to determine the recovery of tax loss carry forwards, research and development expenditures, and investment tax credits.

FINANCIAL INSTRUMENTS

Credit Risk Exposure: Financial instruments that potentially subject the Company to credit risk consist of accounts receivable and a loan receivable. The Company reviews the collectability of its accounts receivable and loan receivable on a regular basis.

Fair Values of Financial Assets and Liabilities: The fair values of accounts receivable, accounts payable and accrued liabilities included in the balance sheets approximate their carrying amounts due to the relatively short period of maturity of the instruments.

OFF BALANCE SHEET ARRANGEMENTS

Future milestone payments for drug development have not been reflected in the financial statements, as the liability is contingent upon meeting certain milestones and obtaining regulatory approvals. Contingent future milestone payments for the Company's current products are $0.6 million.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by IFRS for fiscal years beginning on or after January 1, 2011. Accordingly, the conversion from Canadian GAAP to IFRS will be applicable to the Company's reporting for the first quarter of 2011, for which the current and comparative information will be prepared under IFRS. The Company does not expect that the transition to IFRS will have a material impact on its internal control over financial reporting and its disclosure controls and procedures.

The Company has established an IFRS changeover plan. The first phase of the conversion process was the diagnostic review phase. This was completed in 2009 and the results of the review were presented to the Board of Directors. The next phase of the changeover plan was the detailed planning and implementation phase. This was completed in 2010 and the Company has provided updates in its quarterly MD&As during the year.

IFRS 1 "First time adoption of international financial reporting standards" requires that first time adopters select accounting policies that comply with each IFRS effective at the end of its first IFRS reporting period and apply those policies to all periods presented in its first IFRS financial statements. IFRS1 also provides certain optional exemptions to the full retrospective application. The following is the Company's conclusion with respect to the applicable IFRS optional exemptions:

Share based payment transactions – the Company has elected not to apply IFRS 2 to awards that vested prior to January 1, 2010.

Status of the IFRS Changeover Plan

The following is a summary of the key activities in the Company's IFRS changeover plan as at December 31, 2010.

IFRS Impact Area	Key Activities	Current Status
Accounting policies and financial statement preparation	Identify differences between Canadian GAAP and IFRS accounting policies that impact the Company	The differences are summarized below.
	Selection of IFRS 1 accounting policy choices	IFRS 1 accounting policy choices have been made
	Identify changes required in note disclosure	The review is complete
Information technology and data systems	Identify changes required to financial systems	Completed – no changes required
	Determine processes for capturing financial information under IFRS in 2010 for comparative information	Completed – processes are implemented
Internal control over financial reporting ("ICFR")/Disclosure controls and procedures ("DC&P")	Determine and implement processes for capturing financial information under IFRS in 2010 for comparative information	Completed
Training and communication	Education of management and Audit Committee	Key individuals involved in the changeover process have been trained
	External communication regarding IFRS status	Included in quarterly and year-end MD&As in 2010
Business activities	Identify impact of changeover on contractual arrangements and employee compensation plans	Review of current contract and plans has been completed and there is no impact. New contracts will make reference to IFRS.

Differences between Canadian GAAP and IFRS

A detailed review of the major differences between Canadian GAAP and IFRS was undertaken by the Company. Only the item summarized below has been identified as having a significant impact on the Company's financial statements.

Stock-based Compensation Expense: In certain circumstances, IFRS requires a different measurement of stock-based compensation expense related to stock options than current Canadian GAAP. The Company currently recognizes stock-based compensation expense for options granted over the overall vesting period (i.e. options granted vest over four years, stock compensation expense is recognized over that period). Under IFRS 2, where stock options are granted and vest in instalments over a period, each instalment should be treated as a separate stock option grant. The impact of recognizing stock-based compensation expense by instalment as at January 1, 2010 is a reduction in retained earnings of $0.3 million and an increase in contributed surplus of $0.3 million. The impact on 2010 results is a reduction in stock-based compensation expense of $0.1 million.

CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS"): Commencing in the first quarter of 2011, the Company's financial statements will be prepared in accordance with IFRS, with 2010 comparative figures and the January 1, 2010 opening balance sheet restated to conform with IFRS, along with reconciliations from GAAP to IFRS, in accordance with the guidance provided in IFRS 1, First Time Adoption of International Financial Reporting Standards.

BUSINESS RISKS

Financial: As at December 31, 2010, the Company had cash of $10.3 million. The Company expects these funds will be sufficient to fund current product development and operating costs. The Company expects to incur losses from continuing operations for the near future.

Product: There has been substantial litigation in the pharmaceutical industry concerning the manufacture, use and sale of new products that are the subject of conflicting patent rights. Regardless of FDA approval, should anyone commence a lawsuit with respect to any alleged patent infringement by the Company, the uncertainties inherent in patent litigation make the outcome of such litigation difficult to predict.

The Company currently has three products, two approved and one pending regulatory approval. For each of these products, the Company has filed an IND and NDA with the FDA. Two NDAs have received final FDA approval and one has received an approvable letter. Final FDA approval may not be granted in a timely manner or at all, which would have a material adverse effect on the Company's business. Approval may be refused or delayed for a number of reasons, including challenges of notices of non-infringement by patent holders. Challenges of this type are not uncommon and may delay NDA approval by up to 30 months.

Concentration of Revenue: A significant proportion of the Company's revenue is derived from one customer. The loss of that source of revenue for any reason would have a significant impact on the future cash flow and the financial position of the Company.

Dependence on Strategic Partnerships and Licensees: The Company's success depends, in large measure, on its ability to conclude in-licensing, development, manufacturing, marketing, and distribution agreements with other pharmaceutical companies. Factors that may affect the success of the Company's collaborative efforts with pharmaceutical company partners include the following:

- The Company's partners may be pursuing alternative technologies or developing alternative products, either on their own or in collaboration with others, that may be competitive with the products on which they are collaborating with the Company, which could affect their commitment to the Company's product development efforts;

- The Company's technology partners may not be able to adequately supply its products in commercial quantities, which would adversely affect revenues;

- Reductions in marketing or sales efforts or a discontinuation of marketing or sales of the Company's products by its commercial partners may reduce future revenues, which will be based on a percentage of net sales by these partners; and

- The Company's partners may terminate their collaborations with the Company, which could make it difficult for the Company to attract new partners or adversely affect how the Company is perceived in the business and financial communities.

The development of pharmaceutical products is a process that requires large investments and can take years to complete. Projects can be abandoned along the way or regulatory authorities can refuse to approve new products. With respect to projects the Company initiates, the Company will attempt to minimize risk through the judicious selection of product candidates and by focusing on improving products that have already been marketed.

Regulation: The cost of complying with government regulation can be substantial. Government authorities in the United States, Canada and comparable authorities in foreign countries also regulate the research and development, manufacture, testing, and safety of pharmaceutical products, as well as the approval and commercialization of such products. The regulations applicable to the Company's existing and future products may change. There can be long delays in obtaining required clearances from regulatory authorities in any country after applications are filed. Government agencies in the United States, Canada and other countries in which the Company intends to carry on business regulate pharmaceutical products intended for human use. Regulations require extensive clinical trials and other testing and government review and final approval before the Company can market its products.

Requirements for approval vary widely from country to country outside of the United States and Canada. Whether or not approved in the United States or Canada, regulatory authorities in other countries must approve a product prior to the commencement of marketing the product in those countries. The time required to obtain any such approval may be longer or shorter than in the United States and Canada.

Any failure or delay in obtaining regulatory approvals could adversely affect the market for any products the Company develops and therefore its business, results of operations, financial condition and cash flows.

DISCLOSURE CONTROLS AND PROCEDURES

Cipher's management is responsible for establishing and maintaining disclosure controls and procedures to ensure that information required to be disclosed to satisfy the Company's continuous disclosure obligations is recorded, processed, summarized and reported as required by applicable Canadian securities legislation. Management has carried out an evaluation of the effectiveness as of December 31, 2010 of the design and operation of the disclosure controls and procedures, as defined in *National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*, under the supervision and with the participation of the President and Chief Executive Officer ("CEO"), and the Chief Financial Officer ("CFO"). Based on this evaluation, the CEO and CFO concluded that the disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company to satisfy its continuous disclosure obligations and are effective in ensuring that information required to be disclosed in the reports that the Company files is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Board of Directors has reviewed and approved the Company's policy regarding corporate Disclosure Controls and Procedures. Management has certified that as at December 31, 2010 the design and operation of the disclosure controls and procedures continues to be effective.

Cipher's management is responsible for designing and implementing internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. As required under *National Instrument 52-109*, the Company, under the supervision and with the participation of the CEO and the CFO, has carried out a review of its internal controls over financial reporting. Based on this evaluation, the Company's CEO and CFO concluded that the Company has designed and implemented such internal controls over financial reporting so as to provide reasonable assurance regarding the reliability of the Company's reporting and the preparation of financial statements for external purposes and that there were no changes in the Company's internal control over financial reporting that occurred during the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of Cipher Pharmaceuticals Inc. is responsible for the preparation and presentation of the financial statements in accordance with generally accepted accounting principles. Financial statements are not precise since they include certain amounts based on estimates and judgements. Recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has prepared the financial information presented elsewhere in the annual filings and has ensured that it is consistent with the financial statements.

The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance as to the reliability of the financial information and that the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board is assisted in exercising its responsibilities through the Audit Committee of the Board. The Audit Committee meets with management and auditors to satisfy itself that management's responsibilities are properly discharged, to review the financial statements and to recommend approval of the financial statements to the Board.

The financial statements have been audited by PricewaterhouseCoopers LLP in accordance with generally accepted auditing standards on behalf of the shareholders. The external auditors have full and unrestricted access to the Audit Committee and management to discuss matters arising from their audit, which includes a review of accounting records and internal controls. Their report dated March 8, 2011 outlines the scope of their examination and opinion on the financial statements.

Larry Andrews
President and Chief Executive Officer

Norman Evans
Chief Financial Officer

PRICEWATERHOUSECOOPERS

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March 8, 2011

Independent Auditor's Report

To the Shareholders of
Cipher Pharmaceuticals Inc.

We have audited the accompanying financial statements of Cipher Pharmaceuticals Inc., which comprise the balance sheets as at December 31, 2010 and December 31, 2009 and the statements of operations and comprehensive income (loss), deficit and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of Cipher Pharmaceuticals Inc. as at December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Cipher Pharmaceuticals Inc.
Balance Sheets
(in thousands of dollars)

	As at December 31, 2010	As at December 31, 2009
ASSETS		
Current assets		
Cash	$ 10,328	$ 9,006
Accounts receivable	1,808	967
Prepaid expenses and other current assets	465	457
Loan receivable (note 4)	-	800
	12,601	11,230
Property and equipment, net (note 5)	50	86
Intangible assets, net (note 6)	3,522	3,507
	$ 16,173	$ 14,823
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 2,440	$ 1,570
Current portion of deferred revenue	567	1,956
	3,007	3,526
Deferred revenue	1,692	329
	4,699	3,855
SHAREHOLDERS' EQUITY		
Share capital (note 7)	49,977	49,948
Contributed surplus (note 8)	32,689	32,268
Deficit	(71,192)	(71,248)
	11,474	10,968
	$ 16,173	$ 14,823

The accompanying notes are an integral part of these financial statements

Approved on behalf of the Board:

William Garriock
Chairman

Stephen R. Wiseman
Director

Cipher Pharmaceuticals Inc.

Statements of Operations and Comprehensive Income (Loss)
(in thousands of dollars, except per share amounts)

	For the year ended December 31, 2010	December 31, 2009
Revenues		
Licensing revenue	$ 5,385	$ 3,179
Expenses		
Research and development (note 9)	743	956
Operating, general and administrative	3,895	4,252
Depreciation of property and equipment	53	69
Amortization of intangible assets	704	741
Interest income	(66)	(124)
	5,329	5,894
Income (loss) before income taxes	56	(2,715)
Provision for (recovery of) income taxes (note 10)		
Current	171	-
Future	(171)	-
Income (loss) and comprehensive income (loss) for the year	$ 56	$ (2,715)
Basic and diluted earnings (loss) per share (note 11)	$ 0.00	$ (0.11)

The accompanying notes are an integral part of these financial statements

Statements of Deficit
(in thousands of dollars)

	For the year ended December 31, 2010	December 31, 2009
Deficit, beginning of year	$ (71,248)	$ (68,533)
Income (loss) for the year	56	(2,715)
Deficit, end of year	$ (71,192)	$ (71,248)

The accompanying notes are an integral part of these financial statements

Cipher Pharmaceuticals Inc.
Statements of Cash Flows
(in thousands of dollars)

	For the year ended December 31, 2010	December 31, 2009
Cash provided by (used in)		
Operating activities		
Income (loss) for the year	$ 56	$ (2,715)
Items not affecting cash		
Depreciation of property and equipment	53	69
Amortization of intangible assets	704	741
Stock-based compensation expense	435	655
Imputed interest	-	(87)
	1,248	(1,337)
Net change in non-cash operating items (note 12)	(5)	(20)
	1,243	(1,357)
Investing activities		
Proceeds from loan receivable (note 4)	800	612
Acquisition of intangible rights (note 6)	(719)	(122)
Purchase of property and equipment	(17)	(8)
	64	482
Financing activities		
Proceeds from exercise of stock options	15	-
Increase (Decrease) in cash	1,322	(875)
Cash, beginning of year	9,006	9,881
Cash, end of year	$ 10,328	$ 9,006

The accompanying notes are an integral part of these financial statements

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Significant accounting policies used in the preparation of these financial statements are as follows:

Translation of foreign currencies
Revenues and expenses denominated in foreign currencies are translated into Canadian dollars using the exchange rate in effect at the transaction date. Monetary assets and liabilities are translated using the rate in effect at the balance sheet date and non-monetary items are translated at historical exchange rates. Related exchange gains and losses are included in the determination of the income for the year.

Use of estimates
The preparation of these financial statements requires management to make estimates and assumptions that could affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Significant areas requiring the use of management estimates include the valuation of intangible assets and measurement of income taxes. By their nature, these estimates are subject to measurement uncertainty. Actual results could differ from the estimates and assumptions.

Property and equipment
Property and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method and the following estimated useful lives of the assets or lease terms:

Computer equipment	3 years
Computer software	3 years
Furniture and fixtures	5 years
Leasehold improvements	over the term of the lease

Impairment of long-lived assets
Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate the carrying value may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds the sum of the estimated undiscounted cash flows from the long-lived asset. An impairment loss is measured as the amount by which the carrying amount of the long-lived asset exceeds the estimated fair value.

Intangible assets
Intangible assets consist of marketing and other rights relating to products and are initially recorded at cost. Intangible assets have a finite life and are amortized using the straight-line method over their estimated period of useful life. Amortization commences on the earlier of the date of regulatory (generally, U.S. Food and Drug Administration (“FDA”)) approval for marketing the related product or upon substantive revenue being generated from the product under a commercial licensing agreement. The estimated period of useful life has been determined to be 3.5 years from the date of regulatory approval for marketing the related product. Should amortization commence as a result of generating revenue, the amortization period would include the time prior to regulatory approval. Intangible assets are reviewed for impairment when events or other changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

Revenue recognition
The Company recognizes revenue from product sales contracts and licensing and distribution agreements, which may include multiple elements. The individual elements of each agreement are divided into separate units of accounting, if certain criteria are met. The applicable revenue recognition approach is then applied to each unit. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

Product sales - revenue from product sales contracts is recognized when the product is shipped to the Company's customers, at which time ownership is transferred.

Licensing revenues - for up-front licensing payments and pre-commercialization milestones, revenue is deferred and recognized on a straight-line basis over the estimated term that the Company maintains substantive contractual obligations. Post-commercialization milestone payments are recognized as revenue when the underlying condition is met, the milestone is not a condition to future deliverables and collectability is reasonably assured. Otherwise, these milestone payments are recognized as revenue over the remaining term of the underlying agreement or the term over which the Company maintains substantive contractual obligations. Royalty revenue is recognized in the period in which the Company earns the royalty. Amounts received in advance of recognition as revenue are included in deferred revenue. Revenue from licensing and distribution agreements is presented on a net basis.

Research and development
The Company conducts research and development programs and incurs costs related to these activities, including employee compensation, materials, professional services and services provided by contract research organizations. Research and development costs, net of related tax credits, are expensed in the periods in which they are incurred.

Income taxes
The Company uses the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and income tax bases of assets and liabilities and are measured using enacted or substantively enacted tax rates and laws that will be in effect when the difference is expected to reverse. The Company provides a valuation allowance for future tax assets when it is more likely than not that some or all of the future tax assets will not be realized.

Stock-based compensation
The fair value of stock options granted after October 1, 2002 is recognized as compensation expense on a straight-line basis over the applicable stock option vesting period. Stock-based compensation expense is included in operating, general and administrative expense in the statements of operations and contributed surplus in the balance sheets. The consideration received on the exercise of stock options is credited to share capital at the time of exercise.

Financial instruments
Financial instruments are measured at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at cost or amortized cost. Gains and losses on held-for-trading financial assets and liabilities are recognized in net earnings in the period in which they arise. Unrealized gains and losses, including changes in foreign exchange rates on available-for-sale financial assets, are recognized in comprehensive income until the financial assets are derecognized or impaired, at which time any unrealized gains or losses are recorded in net earnings.

The following is the basis of classification and measurement of the Company's financial instruments:
- Cash is classified as held-for-trading and is measured at fair value;
- Accounts receivable and loan receivable are classified as loans and receivables and recorded at cost, which at initial measurement corresponds to fair value. After initial fair value measurement, they are measured at amortized cost; and
- Accounts payable and accrued liabilities are classified as other financial liabilities. They are initially measured at fair value and, if necessary, subsequent revaluations are recorded at amortized cost.

2 CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS")
Commencing in the first quarter of 2011, the Company's financial statements will be prepared in accordance with IFRS, with 2010 comparative figures and the January 1, 2010 opening balance sheet restated to conform with IFRS, along with reconciliations from GAAP to IFRS, in accordance with the guidance provided in IFRS 1, First-Time Adoption of International Financial Reporting Standards.

3 RISK MANAGEMENT

Financial risk management
In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: credit risk, liquidity risk and market risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse affects on the Company's financial performance.

(i) Credit risk
Accounts receivable - the Company licenses its products to distribution partners in major markets. The credit risk associated with the accounts receivable pursuant to these agreements is evaluated during initial negotiations and on an ongoing basis. There have been no default events under these agreements. As of December 31, 2010, no accounts receivable balances were considered impaired or past due.

(ii) Liquidity risk
The Company has no long term debt with specified repayment terms. Accounts payable and accrued liabilities are settled in the regular course of business, based on negotiated terms with trade suppliers. All components of the balance of $2,169 as at December 31, 2010 are expected to be settled in less than one year. The carrying value of the balances approximate their fair value as the impact of discounting is not significant.

(iii) Market risk
Currency risk - the majority of the Company's revenue and a portion of its expenses are denominated in US currency. The accounts receivable balance at December 31, 2010 includes a total of US$994 and accounts payable and accrued liabilities includes a total of US$1,115. A 10% change in the US/CDN exchange rate on the net December 31, 2010 balance would have had a $12 impact on net income.

Capital risk management
Shareholders' equity is managed as the capital of the Company. The Company's objective when managing capital is to safeguard its ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to minimize the cost of capital. In order to maintain or adjust the capital structure, the Company may issue new common shares from time to time.

4 LOAN RECEIVABLE

During the quarter ended March 31, 2010, the Company received the final instalment of $800 as part of the deferred payment agreement for the sale of Pharma Medica Research Inc. in February 2005.

5 PROPERTY AND EQUIPMENT

The following is a summary of property and equipment as at December 31, 2010:

	December 31, 2010		December 31, 2009	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Computer equipment	$ 123	$ 106	$ 106	$ 97
Computer software	38	38	38	34
Furniture and fixtures	126	112	126	85
Leasehold improvements	67	48	67	35
	354	$ 304	337	$ 251
Accumulated depreciation	(304)		(251)	
	$ 50		$ 86	

6 INTANGIBLE ASSETS

The Company has entered into certain agreements with Galephar Pharmaceutical Research Inc. ("Galephar") for the rights to package, test, obtain regulatory approvals and market certain products in various countries around the world. In accordance with the terms of the agreements, the Company has acquired these intangible rights through an investment in three separate series of preferred shares of Galephar. The preferred shares are redeemable by the Company from amounts received under the licensing agreements for the products. The Company may be required to pay additional amounts to Galephar in respect of the CIP-ISOTRETINOIN intangible rights of up to $646 (US$650) if certain future milestones are achieved as defined in the agreement. These additional payments will be made in the form of Galephar preferred share purchases. The recoverability of these intangible rights is dependant upon sufficient revenues being generated from the related products currently under development and commercialization. The Company is currently amortizing the intangible rights related to CIP-FENOFIBRATE and CIP-ISOTRETINOIN. After product-related expenses are deducted and after the recovery of Cipher's investment in the preferred shares of Galephar, approximately 50% of all milestone and royalty payments received by the Company under the licensing agreements will be paid to Galephar.

CIP-FENOFIBRATE - in July 2007, the Company entered into a licensing and distribution agreement with Kowa Pharmaceuticals America, Inc. ("Kowa"), under which Kowa was granted the exclusive right to market, sell and distribute Lipofen in the United States. Lipofen was launched in the U.S. market in 2007. During the second quarter of 2010, the product reached a cumulative net sales level that resulted in a contract milestone of US$1 million being achieved.

CIP-ISOTRETINOIN - in August 2008, the Company entered into a development and supply agreement with Ranbaxy Pharmaceuticals Inc. ("Ranbaxy") under which Ranbaxy was granted the exclusive right to market, sell and distribute CIP-ISOTRETINOIN in the United States. The Company has received an up-front licensing payment of US$1 million and in 2010 received two milestones totaling US$3 million related to the progress of the clinical trial. Under the terms of the agreement, the Company could receive additional pre- and post-commercialization milestone payments of up to US$20 million, based on the achievement of certain milestone targets. Once the product is successfully commercialized, the Company will also receive a royalty based on a percentage of net sales. Ranbaxy has agreed to reimburse the Company for the costs associated with the clinical studies required by the FDA to secure NDA approval, up to a predetermined cap. Any additional development costs associated with initial FDA approval will be shared equally. The Company is responsible for all product development activities, including management of the clinical studies required by the FDA to secure NDA approval and is also responsible for product supply and manufacturing, which will be fulfilled by Galephar.

CIP-TRAMADOL ER - In May 2010, the Company received final approval from the FDA for its extended-release tramadol product for the treatment of moderate to moderately severe chronic pain in adults. Achieving FDA approval triggered additional milestone payments to Galephar as the Company prepares for commercial manufacturing. During 2010, payments of $719 were made with respect to the intangible rights for CIP-TRAMADOL ER.

The following is a summary of intangible assets as at December 31, 2010:

	December 31, 2010		December 31, 2009	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
CIP-FENOFIBRATE	$ 2,332	$ 2,332	$ 2,332	$ 1,865
CIP-ISOTRETINOIN	1,579	511	1,579	274
CIP-TRAMADOL ER	2,454	-	1,735	-
	6,365	$ 2,843	5,646	$ 2,139
Accumulated amortization	(2,843)		(2,139)	
	$ 3,522		$ 3,507	

7 SHARE CAPITAL

Authorized share capital

The authorized share capital consists of an unlimited number of preference shares, issuable in series, and an unlimited number of voting common shares.

Issued share capital

The following is a summary of the changes in share capital from December 31, 2008 to December 31, 2010:

	Number of common shares (in thousands)	Amount $
Balance outstanding - December 31, 2008 and December 31, 2009	24,055	49,948
Options exercised in 2010	25	29
Balance outstanding - December 31, 2010	24,080	49,977

Stock option plan

The following is a summary of the changes in the stock options outstanding from December 31, 2008 to December 31, 2010:

	Number of options (in thousands)	Weighted average exercise price $
Balance outstanding - December 31, 2008	1,376	2.51
Granted in 2009	224	0.60
Expired in 2009	(20)	4.33
Balance outstanding - December 31, 2009	1,580	2.22
Granted in 2010	222	1.60
Exercised in 2010	(25)	0.61
Balance outstanding - December 31, 2010	1,777	2.17

At December 31, 2010, 1,114,560 options were fully vested and exercisable (806,974 at December 31, 2009).

During 2010, the Company issued 221,500 stock options under the employee and director stock option plan, with an exercise price of $1.60, 25% of which vest on February 19 of each year, commencing in 2011, and expire in 2020. Total compensation cost for these stock options is estimated to be $317. This cost will be recognized over the vesting period of the stock options.

The stock options issued during 2010 were valued using the Black-Scholes option pricing model, with the following assumptions:

Risk-free interest rate	3.50%
Expected life	10 years
Expected volatility	97%
Expected dividend	Nil

During 2010, 25,000 stock options were exercised for a total cash consideration of $15. Capital stock increased by $29, representing the cash consideration of $15 and a $14 reduction in contributed surplus.

7 SHARE CAPITAL (Continued)

The following is a summary of the outstanding options as at December 31, 2010:

Expiry date	Exercise price	Number of options (in thousands)		
	$	Vested	Unvested	Total
January 11, 2012	1.09	125	-	125
September 17, 2014	2.35	125	-	125
March 23, 2016	4.12	200	-	200
June 28, 2016	4.00	180	-	180
September 13, 2016	2.90	69	-	69
March 9, 2017	3.90	168	56	224
February 28, 2018	1.05	107	106	213
November 7, 2018	0.45	90	90	180
December 3, 2018	0.50	20	20	40
February 20, 2019	0.61	26	153	179
November 6, 2019	0.55	5	15	20
February 19, 2020	1.60	-	222	222
		1,115	662	1,777

8 CONTRIBUTED SURPLUS

The following is a summary of the changes in contributed surplus from December 31, 2008 to December 31, 2010:

	Amount $
Balance - December 31, 2008	31,613
Stock-based compensation expense in 2009	655
Balance - December 31, 2009	32,268
Options exercised in 2010	(14)
Stock-based compensation expense in 2010	435
Balance - December 31, 2010	32,689

9 RESEARCH AND DEVELOPMENT

A total of $12,835 of research and development costs were incurred in 2010 ($5,381 in 2009). The research and development expense reflected in the Statement of Operations is presented net of provincial tax credits of $328 ($53 in 2009) for qualifying research and development expenditures and an amount of $11,764 reimbursed by Ranbaxy ($4,372 in 2009). Under the terms of the agreement with Ranbaxy, research and development costs incurred for clinical studies required by the FDA to secure approval for CIP-ISOTRETINOIN are reimbursed to the Company and as a result, there was a nil impact to research and development expense with respect to these expenditures.

10 INCOME TAXES

The provision for income taxes differs from the amount computed by applying the statutory income tax rate to the loss for the year. The sources and tax effects of the differences are as follows:

	For the year ended December 31,	
	2010 $	2009 $
Statutory income tax rate of 31% applied to loss for the year (2009 - 33%)	17	(896)
Permanent differences	154	192
Change in enacted income tax rates and other items	(740)	3,382
Change in valuation allowance	569	(2,678)
Provision for income taxes	-	-

The significant components of future income tax assets are summarized as follows:

	As at December 31, 2010 $	2009 $
Non-capital losses	11,290	9,811
Excess of tax value of property and equipment over book value	28	59
SR&ED expenditure pool	4,186	3,097
Excess of tax value of intangible assets over book value	3,422	6,194
Benefit of investment tax credits	2,673	2,038
Capital losses	217	177
Deductible share issue costs	-	55
Provincial tax credits	289	120
Other temporary differences	422	407
	22,527	21,958
Valuation allowance	(22,527)	(21,958)
	-	-

The Company has non-capital loss carry forwards of $45,200 as at December 31, 2010 that expire in varying amounts from 2014 to 2030.

The Company has Scientific Research and Experimental Development ("SR&ED") expenditures of $16,700 which can be carried forward indefinitely to reduce future years' taxable income.

The Company has approximately $3,500 of investment tax credits on SR&ED expenditures that are available to be applied against federal taxes otherwise payable in future years and expire in varying amounts from 2022 to 2030.

11 EARNINGS PER SHARE

Earnings per share is calculated using the weighted average number of shares outstanding. The weighted average number of shares outstanding for the year ended December 31, 2010 was 24,071,522 (for the year ended December 31, 2009 - 24,054,878). The dilutive impact on earnings per share for the year ended December 31, 2010 is not significant.

Basic and diluted loss per share for prior year comparative figures are the same because the exercise of stock options would have an anti-dilutive effect due to the net losses incurred in 2009.

12 SUPPLEMENTAL CASH FLOW INFORMATION

The following is a summary of the changes in non-cash operating items:

	For the year ended December 31, 2010 $	2009 $
Accounts receivable	(841)	(455)
Prepaid expenses and other current assets	(8)	(71)
Accounts payable and accrued liabilities	870	392
Deferred revenue	(26)	114
	(5)	(20)

13 SEGMENTED INFORMATION

The Company's operations are categorized into one industry segment, being specialty pharmaceuticals. All of the Company's assets, including capital and intangible assets, are in Canada, while all licensing revenue is derived from the United States.

DIRECTORS AND OFFICERS

Larry Andrews
President and Chief Executive Officer

Norman Evans, C.A.
Chief Financial Officer

William Garriock
Chairman of the Board

Stefan Aigner, M.D., CFA.
Director

William Claypool, M.D.
Director

Gerald McDole
Director

John Mull, M.D., F.R.C.P. (C)
Director

Stephen R. Wiseman, C.A.
Director

SENIOR MANAGEMENT

Larry Andrews
President and Chief Executive Officer

Norman Evans, C.A.
Chief Financial Officer

Jason A. Gross, Pharm.D.
Vice President, Scientific Affairs

SHAREHOLDER INFORMATION

Stock Exchange Listing
The Company's common shares are listed on the Toronto Stock Exchange under the symbol "DND".

Annual Meeting
Date: Thursday, May 12, 2011 at 11:00 a.m.
Place: The Toronto Board of Trade
1 First Canadian Place
Toronto, ON, M5X 1C1

Shareholder Inquiries
Inquiries regarding change of address, transfer requirements or lost certificates should be directed to the Company's transfer agent.

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