
IMPROVE
INNOVATE
TRANSFORM

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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.

LETTER TO SHAREHOLDERS

DEAR SHAREHOLDER

In the third quarter of 2011, we achieved three important milestones for our extended-release tramadol product, CIP-TRAMADOL ER.

Vertical Pharmaceuticals, our U.S. marketing partner, launched the product in September under the trade name ConZip™. Vertical has a 60-person sales team with plans to increase it next year, and ConZip™ is their flagship product. Under the agreement with Vertical, we have received US$1.5 million in milestones to date and are eligible to receive future payments of approximately US$3.0 million contingent upon the achievement of certain sales targets. In addition, Cipher will receive a royalty on net sales in the mid-teens.

The third quarter also saw us obtain final Health Canada approval for the product. With sales of more than $60 million in 2010, the total Canadian tramadol market remains robust. Moreover, we completed a licensing agreement with Medical Futures during the quarter. Medical Futures is a growing Canadian private company with a focus on pain, among several other therapeutic areas. Under the terms of the agreement, we will receive up-front payments of approximately CDN$300,000. We are also eligible for future payments upon the achievement of cumulative net sales milestones and will receive a double-digit royalty on net sales. Pre-commercial activities have ramped up quickly, working toward an early Q1 2012 launch under the trade name Durela™. Medical Futures will have a dedicated sales force of approximately 22 representatives to start.

With our high-potential acne product, CIP-ISOTRETINOIN, we continue to prepare our revised New Drug Application with a target submission to the U.S. Food and Drug Administration (FDA) in Q4 2011. The review is expected to take six months. As we disclosed in Q2 of this year, the overall top-line results from our robust Phase III safety study were positive. The data showed no overall statistical differences in the adverse event profile between the two products, which was the key outcome we were aiming for from this study.

In addition, we are expecting to complete a New Drug Application to Health Canada in Q4 of this year using this data. We have conducted a more in-depth analysis of the Canadian market and it points to an attractive opportunity in terms of relative market size, pricing, market access and competition. While there is considerable interest from potential distributors, we are also looking at commercializing the product ourselves, which may offer higher return on investment. We expect to finalize our plans in the coming quarters.

In the third quarter, Lipofen® prescriptions remained consistent with the prior quarter, reflecting continued promotional activity for the product. Lipofen® is in second detail position with our marketing and distribution partner, Kowa Pharmaceuticals America, and we are discussing their 2012 promotional plans for the product. We expect our product will continue to be actively promoted and provide a steady revenue stream to Cipher.

With Lipofen® generating ongoing revenue and our tramadol product now being marketed in the U.S. and set for a Canadian launch in early 2012, we have multiple product revenue streams contributing to our performance for the first time.

FINANCIAL REVIEW

Revenue in Q3 2011 was $1.1 million, similar to Q3 2010. Prior year Q3 results included $0.5 million in non-cash revenue from the original up-front licensing payment on Lipofen®, as well as a milestone payment received in 2009, both of which were being recognized over several quarters, ending in 2010. Results for Q3 2011 include $0.5 million of revenue from extended-release tramadol, representing our first revenue from this product. Royalty revenue from Lipofen® increased by approximately $0.1 million in Q3 2011 compared to Q3 2010.

Research and Development ("R&D") expense for Q3 2011 was $0.5 million, an increase of $0.3 million compared to Q3 2010. The year-over-year increase reflects spending on the CIP-ISOTRETINOIN clinical study, which is now completed. The reported R&D for Q3 2011 is net of $0.2 million of reimbursed R&D costs related to the CIP-ISOTRETINOIN Phase III clinical study. We do not expect to incur any additional material clinical development costs for CIP-ISOTRETINOIN in the current year.

Operating, General and Administrative expenses for Q3 2011 were $0.7 million, compared with $0.9 million in Q3 2010. Net loss in Q3 2011 was $0.2 million ($0.01 per share), the same as in Q3 2010.

Our financial position strengthened during the quarter. At September 30, 2011, Cipher had cash of $9.2 million, compared with $8.6 million at June 30, 2011 and continued to have no debt. We expect to receive additional milestone payments in the coming quarters from the distribution and supply agreements in place on its current products.

OUTLOOK

In summary, we are pleased with the progress we have made this year in advancing our product portfolio. With two ongoing royalty revenue streams, we are positioned to deliver stronger financial results. And with some sizeable milestone payments on the horizon, our financial position continues to strengthen.

Looking ahead, we have several key milestones in the coming quarters:

- Completing our FDA and Health Canada submissions for CIP-ISOTRETINOIN
- The launch of Durela™ into the Canadian market in Q1 2012.
- Advancing discussions with distributors in other jurisdictions for our extended-release tramadol and isotretinoin products; and
- Expanding our product portfolio.

We look forward to updating you on our progress with the release of our full-year 2011 results

Sincerely,

Larry Andrews
President and Chief Executive Officer

CIPHER MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") for the three months ended September 30, 2011. This document should be read in conjunction with the unaudited interim financial statements and the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Additional information about the Company, including the audited 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 October 25, 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 commercial-stage 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 been approved in the U.S. and Canada under the trademarks ConZip™ and Durela™, respectively. CIP-ISOTRETINOIN's U.S. application has been filed and the Company is preparing a revised NDA for Q4 2011 which includes the results of a recently completed Phase III 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 grown steadily 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, which was executed in 2007, is for a period of ten years and they have the right to extend the term for two additional two-year periods

Lipofen was launched in the U.S. market in late 2007 and monthly prescriptions have grown as Kowa increased coverage of the primary care physicians in its targeted regions and expanded its sales force. Kowa's sales force has grown to approximately 250. Kowa launched another product, Livalo, in Q3 2010, moving Lipofen to the second position in physician detailing time. While this had a predictable near-term effect on the growth of new Lipofen prescriptions in the second half of 2010, the impact was offset by a contractual increase in Cipher's royalty percentage and a product price increase. The product continues to be actively promoted by Kowa and during Q3 2011 monthly prescriptions remained steady, relative to the prior quarter.

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 trial-related milestones achieved to date have resulted in additional payments from RPI of US$3 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 agreed to reimburse Cipher for the costs associated with the clinical studies required to obtain FDA approval, up to a predetermined cap, with additional development costs associated with initial FDA approval being shared equally. The contractual cap amount was exceeded in Q1 2011, and Cipher's share of the additional costs during Q3 2011 totalled $0.2 million ($0.9 million on a year-to-date basis). These costs are reflected in research and development expenses. The Company does not expect any material additional R&D costs for the Phase III study.

In Q2 2011 Cipher completed its pivotal Phase III safety trial for the product. The study, which was conducted under an FDA Special Protocol Assessment, was a randomized double-blinded trial comparing the safety profile of CIP-ISOTRETINOIN to an FDA-approved, commercially available isotretinoin product. During Q2 2011, Cipher also disclosed top-line results from the study. From a safety perspective, the top-line data was positive showing no overall statistical differences in the adverse event profile between the two products. The most frequent side effects that were observed were dry skin and dry lips. In addition, initial statistics on psychiatric disorders, eye disorders, ear disorders, musculoskeletal, vascular disorders, cardiac disorders,

and gastrointestinal disorders, illustrate there are no significant differences in the extent of adverse events between CIP-ISOTRETINOIN and the reference product.

The efficacy component of the study had two co-primary endpoints: (1) the total change in lesion counts between baseline and the end of week 20; and (2) the total number of subjects that had at least a 90% clearing at the end of twenty weeks of treatment. These two co-primary endpoints were analyzed using the per-protocol population ("PP") as well as the intent-to-treat population ("ITT"). The PP analysis comprised all subjects who completed the study according to the protocol. In this analysis both co-primary endpoints met the non-inferiority margins established for the study. The ITT population comprised all subjects who entered the study and included those who did not conclude the study for whatever reason. Those who dropped out early were assigned treatment efficacy scores based on the last observation recorded for that subject, also known as last observation carried forward ("LOCF"). In the LOCF analysis of the ITT population, the first primary endpoint was achieved while the second endpoint fell slightly outside the non-inferiority margin target.

The safety, efficacy, and population pharmacokinetic data generated from this study, together with previously submitted data, will be used to complete a revised NDA being prepared for submission to the FDA in Q4 2011. The FDA review of this submission under PDUFA is expected to be six months. A regulatory submission to Health Canada is also planned for Q4 2011.

CIP-TRAMADOL ER

In May 2010, Cipher received FDA approval for CIP-TRAMADOL ER, the Company's extended-release tramadol product, for the treatment of moderate to moderately severe chronic pain in adults. During Q4 2010, the U.S. Patent and Trademark Office issued a patent for CIP-TRAMADOL ER and during Q2 2011, the Canadian Intellectual Property Office issued a patent for the product.

During Q2 2011, Cipher entered into a distribution and supply agreement with Vertical Pharmaceuticals, Inc., ("Vertical") a U.S.-based specialty pharmaceutical company, under which Cipher granted Vertical the exclusive right to market, sell and distribute CIP-TRAMADOL ER in the United States. Under the terms of the agreement with Vertical, Cipher received an initial upfront payment of US$0.5 million and will receive additional payments totaling US$1.0 million 30 days after the first commercial sale of the product, which occurred in September 2011. Cipher is also eligible to receive future payments of approximately US$4 million contingent upon the achievement of certain sales milestones. In addition, Cipher will receive a royalty on net sales in the mid-teens. The product was launched by Vertical in September 2011 under the trade name ConZip™. Vertical's dedicated sales force comprises 60 representatives, with plans for further expansion in the first half of 2012.

During Q3 2011, Cipher received Health Canada approval for CIP-TRAMADOL ER and also completed a Canadian distribution and supply agreement with Medical Futures Inc. ("Medical Futures"). Under the terms of the agreement with Medical Futures, Cipher received an upfront payment of $150,000 and expects to receive an additional payment of $150,000 upon the commercial launch of the product. Cipher is also eligible to receive future payments contingent upon the achievement of cumulative net sales milestones. Medical Futures plans to launch the product under the trade name Durela™ in Q1 2012 with a dedicated sales force comprising approximately 22 representatives initially. In addition, Cipher will receive a double-digit royalty on net sales.

NEW PRODUCTS AND OUT-LICENSING ACTIVITIES

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

REVIEW OF OPERATING RESULTS:

Revenues (in thousands of dollars):

For the nine month periods ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Licensing revenue	2,522	4,217	(1,695)	(40)

For the three month periods ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Licensing revenue	1,120	1,081	39	4

For the quarter ended September 30, 2011, the Company recorded licensing revenue of $1.1 million, slightly higher than Q3 2010.

Revenue from CIP-TRAMADOL ER was $0.5 million in Q3 2011. This is the first quarter that revenue has been recognized for this product.

Revenue from Lipofen in Q3 2011 totalled $0.5 million, a decrease of $0.5 million compared to Q3 2010. In Q3 2010 the Company was still recognizing revenue on the original up-front licensing payment from Kowa as well as a milestone payment received in 2009, both of which were being recognized over several quarters. Non-cash revenue recognized on these items during Q3 2010 totalled $0.5 million. Revenue for these items was fully recognized by the end of 2010. Excluding this item, royalty revenue from Lipofen showed a slight increase of just under $0.1 million in Q3 2011 compared to Q3 2010.

Revenue from CIP-ISOTRETINOIN was $0.1 million in Q3 2011, the same amount as in Q2 2010, which relates to revenue recognized on the Company's share of the up-front licensing payment and milestones received to date.

Research and Development Expense (in thousands of dollars):

For the nine months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Research and development	1,593	743	850	114

For the three months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Research and development	468	220	248	113

Research and development ("R&D") expense represents the cost of the Company's drug development activities.

R&D expense during Q3 2011 was $0.5 million, an increase of $0.3 million compared to Q3 2010. The increase over prior year reflects spending on the CIP-ISOTRETINOIN clinical study, which is now completed.

The reported R&D expense amount of $0.5 million for Q3 2011 is net of $0.2 million of reimbursed R&D expenditures related to the CIP-ISOTRETINOIN Phase III clinical study and the impact of R&D refundable tax credits recorded in the quarter. The Company does not expect to incur any additional material clinical development costs for CIP-ISOTRETINOIN in the current year.

Operating, General and Administrative Expense ("OG&A")

(in thousands of dollars):

For the nine months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Operating, general & administrative	2,433	2,879	(446)	(15)

For the three months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Operating, general & administrative	659	938	(279)	(30)

OG&A expense in Q3 2011 was $0.7 million compared to $0.9 million in Q3 2010. The reduction in OG&A expense compared to prior year mainly reflects a foreign exchange gain during the period and a reduction in certain outside services.

Amortization of Intangible Assets **(in thousands of dollars):**

For the nine months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Amortization of intangible assets	353	528	(175)	(33)

For the three months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Amortization of intangible assets	234	176	58	33

Cipher began amortizing the intangible rights associated with CIP-TRAMADOL in Q3 2011. The Company began amortizing the intangible rights associated with CIP-ISOTRETINOIN in 2009. The Company began amortizing the intangible rights related to CIP-FENOFIBRATE in 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 nine months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Interest income	65	40	25	63

For the three months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Interest income	22	22	0	0

Interest is earned on the Company's cash balance.

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 include non-capital loss carry forwards of approximately $45 million, R&D expenditures of approximately $17 million and other items totalling approximately $11 million, 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.

Earnings (loss) per Share:

For the nine months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Income (loss) (in thousands of dollars)	(1,821)	67	(1,888)	nm
Basic and diluted income (loss) per share	(0.08)	0.00	(0.08)	nm

For the three months ended September 30,

	2011	2010	$ change in 2011	% change in 2011
Income (loss) (in thousands of dollars)	(227)	(243)	16	7
Basic and diluted income (loss) per share	(0.01)	(0.01)	0	7

nm – the % change calculation is not meaningful

Loss per share is calculated using the weighted average number of shares outstanding. The loss in Q3 2011 was $0.2 million, or $0.01 per share, the same as in Q3 2010. The weighted average number of shares outstanding for the three months ended September 30, 2011 was 24,225,801.

For the nine month period ended September 30, 2011, the loss was $1.8 million, or $0.08 per share, compared with net income of $0.1 million, or $0.00 per share, for the corresponding period last year. The weighted average number of shares outstanding for the nine months ended September 30, 2011 was 24,138,236.

SUMMARY OF QUARTERLY RESULTS:

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

For the nine month period ended September 30, 2011 (in accordance with IFRS)

	Q1	Q2	Q3	2011 YTD Total
Licensing revenue	675	727	1,120	2,522
Research & development[(1)]	547	578	468	1,593
Operating, general and administrative	1,164	610	659	2,433
Depreciation of property and equipment	13	8	8	29
Amortization of intangible assets	59	60	234	353
Interest income	23	20	22	65
Loss	1,085	509	227	1,821
Loss per share	0.05	0.02	0.01	0.08

(1) Reported R&D expense for 2011 is net of provincial tax credits of $90 and reimbursements from Ranbaxy for R&D costs for CIP-ISOTRETINOIN of $1,656

For the year ended December 31, 2010 (in accordance with IFRS)

	Q1	Q2	Q3	Q4	2010 Total
Licensing revenue	918	2,218	1,081	1,168	5,385
Research & development[(2)]	278	245	220	0	743
Operating, general and administrative	935	1,006	938	900	3,779
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)	(479)	789	(243)	105	172
Earnings (loss) per share	(0.02)	0.03	(0.01)	0.00	0.00

(2) 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 (in accordance with Canadian GAAP)

	Q1	Q2	Q3	Q4	2009 Total
Licensing revenue	602	678	1,067	832	3,179
Research & development[(3)]	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
Loss	777	784	518	636	2,715
Loss per share	0.03	0.03	0.02	0.03	0.11

(3) 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

LIQUIDITY AND CAPITAL RESOURCES:

The cash balance at September 30, 2011 was $9.2 million, compared to $10.3 million as at December 31, 2010 and $8.6 million as at June 30, 2011. 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 $2.7 million at September 30, 2011, compared to $1.8 million as at December 31, 2010. The product launch milestone for ConZip™ of US$750,000 which is due on October 30, 2011 is the main contributor to the increase.

The balance of accounts payable and accrued liabilities was $2.6 million at September 30, 2011 compared to $2.4 million as at December 31, 2010. The increase in accounts payable and accrued liabilities from December 31, 2010 is a normal course change related to the business operating cycle.

Deferred revenue relates to amounts received in advance of recognition as revenue. The balance of $2.7 million at September 30, 2011 relates to the up-front licensing payment and pre-commercialization milestone payments received by Cipher under the CIP-ISOTRETINOIN and CIP-TRAMADOL ER distribution and supply agreements, net of revenue recognized to date. The deferred revenue balance at December 31, 2010 was $2.3 million.

The development of pharmaceutical products is a process that requires significant investment. 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 September 30, 2011, there are no capital lease contractual obligations. The only significant operating lease contractual obligation is the Company's office location, which expires in May 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 September 30, 2011 the Company had 24,263,317 common shares issued and outstanding. Subsequent to the end of the quarter, 12,635 common shares were issued under the employee and director share purchase plan, bringing the total number of common shares issued and outstanding to 24,275,952 as of the date of this MD&A.

During the three months ended September 30, 2011, the Company issued 78,994 common shares under the employee and director share purchase plan. No stock options were issued in the three months ended September 30, 2011. Share-based compensation expense in the three months ended September 30, 2011 was $0.1 million, the same amount as in the third quarter of 2010.

CRITICAL ACCOUNTING ESTIMATES:

A summary of significant accounting policies is included in Note 1 of the Notes to Financial Statements for the period 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. In addition, management is required to estimate the useful lives of the intangible assets. 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. The Company reviews the collectability of its accounts 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.

Forward Exchange Contracts: The Company utilizes derivative financial instruments in the normal course of its operations as a means to manage risks from fluctuations in foreign exchange. From time to time the Company enters into U.S. currency foreign exchange forward contracts in order to hedge future U.S. cash flow surpluses, where the amount and timing of receipt of such funds is reasonably predictable. In Q3 2011 the Company entered into a foreign exchange forward contract to deliver US$1.5 million at a fixed rate of exchange of $1 US = $1.0285 CDN on November 4, 2011 related to two known U.S. amounts receivable that are expected to be collected in late October 2011 related to product distribution agreements.

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 $0.7 million.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS"):

The Company has adopted International Financial Reporting Standards ("IFRS") for its 2011 fiscal year as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. The Company provided information on its transition to IFRS in its 2010 Annual Management's Discussion and Analysis and the assessments included therein remain largely unchanged and highlighted the impact of IFRS 2 on conversion.

In certain circumstances IFRS requires a different measurement of share-based compensation expense related to stock options than Canadian GAAP. Previously, the Company recognized share-based compensation expense for options granted over the overall vesting period (i.e. options vest over four years and share-based compensation expense was 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 share-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 share-based compensation expense of $0.1 million.

The Company has provided a detailed explanation of the impacts of this transition in Note 3 of the Company's third quarter 2011 unaudited financial statements. The note includes reconciliations of the Company's shareholder's deficit and contributed surplus from Canadian GAAP to IFRS as at September 30, 2011, December 31, 2010 and January 1, 2010 and its fiscal 2010 comprehensive income (loss) for the year ended December 31, 2010 and the quarter ended September 30, 2010. Explanations of the individual impacts of adopting IFRS identified in the reconciliations are also provided, as are the Company's elections under IFRS 1 "First time Adoption of International Financial Reporting Standards".

CHANGES IN ACCOUNTING POLICIES:

International Financial Reporting Standards ("IFRS"): Commencing in the first quarter of 2011, the Company's financial statements are 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 September 30, 2011, the Company had cash of $9.2 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.

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 collaboration agreements with the Company's partners can be terminated by either party in the case of a material default in the terms of the agreements. Should one of these agreements be terminated, it could be difficult for the Company to attract new partners and it may 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:

There have been no changes in the Company's internal control over financial reporting during the most recent interim period ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Cipher Pharmaceuticals Inc.

Financial Statements

For the Nine Months Ended September 30, 2011

(Unaudited)

Cipher Pharmaceuticals Inc.
Balance Sheets

As at September 30, 2011, December 31, 2010 and January 1, 2010
(in thousands of Canadian dollars - unaudited)

	Note	September 30, 2011	December 31, 2010	January 1, 2010
		$	$	$
ASSETS				
Current assets				
Cash		9,235	10,328	9,006
Accounts receivable		2,704	1,808	967
Prepaid expenses and other assets		90	465	457
Loan receivable		-	-	800
		12,029	12,601	11,230
Property and equipment, net		33	50	86
Intangible assets, net	4	3,169	3,522	3,507
		15,231	16,173	14,823
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	5	2,613	2,440	1,570
Current portion of deferred revenue		998	567	1,956
		3,611	3,007	3,526
Deferred revenue		1,720	1,692	329
		5,331	4,699	3,855
SHAREHOLDERS' EQUITY				
Share capital	6	50,133	49,977	49,948
Contributed surplus	3	32,981	32,890	32,585
Deficit	3	(73,214)	(71,393)	(71,565)
		9,900	11,474	10,968
		15,231	16,173	14,823

The accompanying notes are an integral part of these unaudited financial statements

Cipher Pharmaceuticals Inc.

Statements of Operations and Comprehensive Income (Loss)

For the three and nine month periods ended September 30, 2011 and 2010
(in thousands of Canadian dollars, except per share data - unaudited)

	Note	Three months		Nine months	
		September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
		$	$	$	$
Revenues					
Licensing revenue		1,120	1,081	2,522	4,217
Expenses					
Research and development		468	220	1,593	743
Operating, general and administrative		659	938	2,433	2,879
Depreciation of property and equipment		8	12	29	40
Amortization of intangible assets		234	176	353	528
Interest income		(22)	(22)	(65)	(40)
	7	1,347	1,324	4,343	4,150
Income (loss) and comprehensive income (loss) for the period	3	(227)	(243)	(1,821)	67
Basic and diluted earnings (loss) per share	9	(0.01)	-0.01	-0.08	0.00

The accompanying notes are an integral part of these unaudited financial statements

Cipher Pharmaceuticals Inc.
Statements of Changes in Equity

For the nine month periods ended September 30, 2011 and 2010
(in thousands of Canadian dollars - unaudited)

	Share Capital	Contributed Surplus	Deficit	Total Shareholders' Equity
	$	$	$	$
Balance, January 1, 2011	49,977	32,890	(71,393)	11,474
Loss and comprehensive loss for the period	-	-	(1,821)	(1,821)
Exercise of stock options	90	(43)	-	47
Shares issued under the stock purchase plan	66	-	-	66
Share-based compensation - stock option plan	-	134	-	134
Balance, September 30, 2011	50,133	32,981	(73,214)	9,900
Balance, January 1, 2010	49,948	32,585	(71,565)	10,968
Income and comprehensive income for the period	-	-	67	67
Exercise of stock options	29	(14)	-	15
Share-based compensation - stock option plan	-	246	-	246
Balance, September 30, 2010	49,977	32,817	(71,498)	11,296

The accompanying notes are an integral part of these unaudited financial statements

Cipher Pharmaceuticals Inc.

Statements of Cash Flows

For the three and nine month periods ended September 30, 2011 and 2010
(in thousands of Canadian dollars - unaudited)

	Note	Three months September 30, 2011	Three months September 30, 2010	Nine months September 30, 2011	Nine months September 30, 2010
		$	$	$	$
Cash provided by (used in)					
Operating activities					
Income (loss) for the period		(227)	(243)	(1,821)	67
Items not affecting cash:					
Depreciation of property and equipment		8	12	29	40
Amortization of intangible assets	4	234	176	353	528
Share-based compensation - share purchase plan	6	10	-	10	-
Share-based compensation - stock option plan		53	76	134	246
		78	21	(1,295)	881
Changes in non-cash operating items:					
Accounts receivable		(874)	1,306	(896)	(578)
Prepaid expenses and other assets		117	60	375	364
Accounts payable and accrued liabilities		784	(218)	173	996
Deferred revenue		507	(570)	459	(226)
Net cash generated from (used in) operating activities		612	599	(1,184)	1,437
Investing activities					
Proceeds from loan receivable		-	-	-	800
Purchase of property and equipment		(6)	(2)	(12)	(16)
Acquisition of intangible rights		-	(369)	-	(704)
Net cash generated from (used in) investing activities		(6)	(371)	(12)	80
Financing activities					
Proceeds from exercise of stock options and from shares issued under the share purchase plan		56	-	103	15
Increase (Decrease) in cash		662	228	(1,093)	1,532
Cash, beginning of period		8,573	10,310	10,328	9,006
Cash, end of period		9,235	10,538	9,235	10,538

The accompanying notes are an integral part of these unaudited financial statements

(in thousands of Canadian dollars, except per share amounts - unaudited)

1 NATURE OF OPERATIONS

Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") is a commercial stage drug development company focused on commercializing novel formulations of successful, currently marketed molecules using advanced drug delivery technologies. The Company's strategy is to in-license products that incorporate proven drug delivery technologies and advance them through the clinical development and regulatory approval stages, after which the products are out-licensed to international partners. Cipher is incorporated under the Business Corporations Act of Ontario and is located at 5650 Tomken Boulevard, Mississauga, Ontario.

2 BASIS OF PREPARATION AND ADOPTION OF IFRS

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards, and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company is now reporting on this basis in its interim financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These interim financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 3, the Company has consistently applied the same accounting policies in its opening IFRS balance sheet at January 1, 2010 and throughout all periods presented, as if these policies had been in effect. Note 3 discloses the impact of the transition to IFRS on the Company's balance sheet, statement of operations and comprehensive loss and statement of cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended December 31, 2010.

The policies applied in these interim financial statements are based on IFRS issued and outstanding as of October 25, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual financial statements for the year ending December 31, 2011 could result in restatement of these interim financial statements, including the transition adjustments recognized on the change-over to IFRS.

These interim financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010 and the Company's interim financial statements for the three month period ended March 31, 2011 prepared in accordance with IFRS applicable to the preparation of interim financial statements. Note 3 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these interim financial statements.

3 TRANSITION TO IFRS

The effect of the Company's transition to IFRS, described in note 2, is summarized in this note as follows:

(i) Transition elections
(ii) Reconciliation of deficit, contributed surplus, comprehensive loss and cash flow as previously reported under Canadian GAAP to IFRS
(iii) Disclosure of additional IFRS information for the year ended December 31, 2010

(i) Transition elections:
IFRS 1 - First-time Adoption of International Financial Reporting Standards - sets forth guidance for the initial adoption of IFRS. Under IFRS 1, the standards are applied retrospectively at the transitional balance sheet date with all adjustments to assets and liabilities taken to retained earnings unless certain exemptions are applied. The Company has applied the following exemption to its opening balance sheet dated January 1, 2010:

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

With regard to the designation of financial assets and liabilities, the Company has elected to re-designate cash from the held-for-trading category to the loans and receivables category. In addition, as required by IFRS 1, estimates made under IFRS at the date of transition must be consistent with estimates made for the same date under previous GAAP, unless there is evidence that those estimates were in error.

(ii) Reconciliation of deficit, contributed surplus, comprehensive loss and cash flow as previously reported under Canadian GAAP to IFRS:
In preparing its financial statements in accordance with IFRS, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flow is set out below.

Deficit

	As at Dec 31, 2010	As at Sept 30, 2010	As at Jan 1, 2010
As reported under Canadian GAAP	$ (71,192)	$ (71,277)	$ (71,248)
Increase in deficit for:			
Share-based compensation expense - IFRS 2	(201)	(221)	(317)
As reported under IFRS	$ (71,393)	$ (71,498)	$ (71,565)

(in thousands of Canadian dollars, except per share amounts - unaudited)

Contributed Surplus

	As at Dec 31, 2010	As at Sept 30, 2010	As at Jan 1, 2010
As reported under Canadian GAAP	$ 32,689	$ 32,596	$ 32,268
Increase in contributed surplus for:			
Share-based compensation expense - IFRS 2	201	221	317
As reported under IFRS	$ 32,890	$ 32,817	$ 32,585

Comprehensive Income (loss)

	Year Ended Dec 31, 2010	Nine Months Ended Sept 30, 2010	Three Months Ended Sept 30, 2010
As reported under Canadian GAAP	$ 56	$ (29)	$ (260)
Increase in comprehensive income for:			
Share-based compensation expense - IFRS 2	116	96	17
As reported under IFRS	$ 172	$ 67	$ (243)

Operating, general and administrative expense

	Year Ended Dec 31, 2010	Nine Months Ended Sept 30, 2010	Three Months Ended Sept 30, 2010
As reported under Canadian GAAP	$ 3,895	$ 2,975	$ 955
Decrease in operating, general and administrative expense for:			
Share-based compensation expense - IFRS 2	(116)	(96)	(17)
As reported under IFRS	$ 3,779	$ 2,879	$ 938

Statements of cash flows - the transition to IFRS had no significant impact on cash flows generated by the Company.

Under IFRS, the Company accrues the cost of employee stock options over the vesting period using the graded method of amortization rather than the straight-line method, which was the Company's policy under Canadian GAAP. As a result of this change, contributed surplus increased by $317 and deficit increased by $317 as at January 1, 2010. General and administrative expenses decreased by $96 for the nine months ended September 30, 2010 and by $116 for the year ended December 31, 2010.

(iii) Disclosure of additional IFRS information for the year ended December 31, 2010:
Certain disclosures required in annual IFRS financial statements were not previously disclosed in the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010. Certain note disclosures in these interim financial statements include December 31, 2010 information as if it had been reported under IFRS.

Compensation of key management - key management includes directors and executives of the Company. The compensation paid or payable to key management for services is shown below:

	Nine Months Ended Sept 30, 2011	Nine Months Ended Sept 30, 2010	Year Ended Dec 31, 2010
Salaries and short-term employee benefits, including bonuses	$ 934	$ 1,095	$ 1,345
Directors fees	220	217	275
Share-based compensation expense	120	221	287
	$ 1,274	$ 1,533	$ 1,907

(in thousands of Canadian dollars, except per share amounts - unaudited)

4 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 $675 (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-ISOTRETINOIN and CIP-TRAMADOL. 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.

The following is a summary of intangible assets as at September 30, 2011:

	CIP-Fenofibrate	CIP-Isotretinoin	CIP-Tramadol	Total
As at December 31, 2010				
Cost	$ 2,332	$ 1,579	$ 2,454	$ 6,365
Accumulated amortization	(2,332)	(511)	-	(2,843)
Net book value	$ -	$ 1,068	$ 2,454	$ 3,522
For the nine month period ended September 30, 2011				
Opening net book value	$ -	$ 1,068	$ 2,454	$ 3,522
Additions	-	-	-	-
Amortization	-	(178)	(175)	(353)
Net book value	$ -	$ 890	$ 2,279	$ 3,169
As at September 30, 2011				
Cost	$ 2,332	$ 1,579	$ 2,454	$ 6,365
Accumulated amortization	(2,332)	(689)	(175)	(3,196)
Net book value	$ -	$ 890	$ 2,279	$ 3,169

The Company has considered indicators of impairment as of January 1, 2010, December 31, 2010 and September 30, 2011. No indicators were identified and therefore no impairment test was required.

5 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The following is a summary of accounts payable and accrued liabilities as at September 30, 2011 and December 31, 2010:

	As at Sept 30, 2011	As at Dec 31, 2010
Trade accounts payable	$ 1,297	$ 1,580
Accrued liabilities	1,316	860
	$ 2,613	$ 2,440

6 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 January 1, 2010 to September 30, 2011:

	Number of common shares (in thousands)	Amount $
Balance outstanding - January 1, 2010	24,055	49,948
Options exercised in 2010	25	29
Balance outstanding - December 31, 2010	24,080	49,977
Options exercised in Q2 2011	104	90
Shares issued in Q3 2011 under the share purchase plan	79	66
Balance outstanding - September 30, 2011	24,263	50,133

Share purchase plan - Effective May 13, 2011, the Company implemented an Employee and Director Share Purchase Plan ("ESPP") to allow employees and directors to share in the growth of the Company through share ownership. Through the ESPP, employees and directors may contribute amounts from payroll to be used to purchase shares of the Company at a 15% discount from the prevailing trading price. The shares issued under the ESPP are new shares issued from treasury. During the three month period ended September 30, 2011, 78,994 shares were issued under the ESPP. Included in share based compensation expense is $10 associated with the ESPP for the three month period ended September 30, 2011.

Stock option plan
The following is a summary of the changes in the stock options outstanding from January 1, 2010 to September 30, 2011:

	Number of options (in thousands)	Weighted average exercise price $
Balance outstanding - January 1, 2010	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
Granted during the three months ended March 31, 2011 (a)	196	1.16
Cancelled during the three months ended March 31, 2011	(100)	0.72
Exercised during the three months ended June 30, 2011 (b)	(104)	0.45
Expired during the three months ended September 30, 2011	(10)	1.49
Balance outstanding - September 30, 2011	1,759	2.24

At September 30, 2011, 1,231,153 options were fully vested and exercisable (1,054,560 at September 30, 2010).

(a) During the three months ended March 31, 2011, the Company issued 196,000 stock options under the employee and director stock option plan, with an exercise price of $1.16, 25% of which vest on March 11 of each year, commencing in 2012, and expire in 2021. Total compensation cost for these stock options is estimated to be $198, which will be recognized on a graded basis over the vesting period of the stock options.

The stock options issued during the three months ended March 31, 2011 were valued using the Black-Scholes option pricing model, with the following assumptions. Expected volatility is based on the Company's historical volatility, while estimated forfeitures are not considered significant.

Risk-free interest rate	3.27%
Expected life	10 years
Expected volatility	90.7%
Expected dividend	Nil

(b) During the three months ended June 30, 2011, 104,445 stock options were exercised for a total cash consideration of $47. Capital stock increased by $90 representing the cash consideration of $47 and a $43 transfer from contributed surplus.

(in thousands of Canadian dollars, except per share amounts - unaudited)

7 EXPENSES BY NATURE

	Nine Months Ended Sept 30, 2011	Nine Months Ended Sept 30, 2010
Employees salaries and directors fees	$ 1,520	$ 1,542
Share-based compensation	134	245
Depreciation and amortization	382	568
Professional fees	644	501
Contract research	895	-
Other expenses, net of interest income	768	1,294
	$ 4,343	$ 4,150

8 FOREIGN EXCHANGE FORWARD TRANSACTION

The Company utilizes derivative financial instruments in the normal course of its operations as a means to manage risks from fluctuations in foreign exchange. From time to time, the Company enters into U.S. currency foreign exchange forward contracts in order to hedge future U.S. cash flow surpluses, where the amount and timing of receipt of such funds is reasonably predictable. In Q3 2011, the Company entered into a foreign exchange forward contract to deliver US$1.5 million at a fixed rate of exchange of $1 US = $1.0285 CDN on November 4, 2011 related to two known U.S. amounts receivable that are expected to be collected in late October 2011 related to product distribution agreements. The foreign exchange forward contract is considered an effective cash flow hedge and qualifies for hedge accounting.

9 EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is calculated using the weighted average number of shares outstanding. The weighted average number of shares outstanding for the three and nine month periods ended September 30, 2011 was 24,225,801 and 24,138,236 respectively (for the three and nine month periods ended September 30, 2010 respectively 24,079,878 and 24,068,706).

As the Company had a loss for the three and nine month periods ended September 30, 2011 and for the three month period ended September 30, 2010, basic and diluted loss per share are the same because the exercise of all stock options would have an anti-dilutive effect. For the prior year, the dilutive impact on earnings per share for the nine month period ended September 30, 2010 is not significant.

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".

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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