
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.

LETTER TO SHAREHOLDERS

DEAR SHAREHOLDER

The second quarter of 2011 was an eventful period for Cipher with two key development and commercialization milestones reached.

First, we completed the Phase III safety trial for CIP-ISOTRETINOIN and announced top-line safety and efficacy results from the study. Overall, the top-line results were positive. From a safety perspective, the top-line data showed no overall statistical differences in the adverse event profile between CIP-ISOTRETINOIN and the reference product. This was the key outcome we were aiming to achieve in our study. The efficacy component of the study had two co-primary endpoints. These two co-primary endpoints were analyzed using the per-protocol ("PP") population as well as the intent-to-treat ("ITT") population. The PP population comprised all subjects who completed the study according to the protocol. In this analysis, both primary endpoints met the non-inferiority margin established for the study. The ITT population comprised all subjects who entered the study, including those who did not conclude the study for whatever reason. In 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 New Drug Application 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.

The second key milestone in Q2 2011 was completion of a definitive distribution and supply agreement with Vertical Pharmaceuticals, Inc., a U.S.-based specialty pharmaceutical company, under which we have 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 with additional payments totaling US$1.0 million due upon the first commercial sale of the product. 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. Vertical plans to launch the product in Q3 2011 under the trade name ConZip™ which will give us two royalty-generating products in the U.S. market. Vertical's dedicated sales force will comprise 60 representatives at the time of product launch, with plans for further expansion in the first half of 2012.

During Q2 2011, the Canadian Intellectual Property Office issued a patent for CIP-TRAMADOL ER. In addition, Cipher expects a response from Health Canada concerning regulatory approval in Q3 2011.

In the second quarter, Lipofen® prescriptions remained steady, reflecting continued promotional activity for the product. Lipofen remains in second position with our marketing and distribution partner, Kowa Pharmaceuticals America Inc. ("Kowa"), and we expect it to be promoted in second position throughout 2011, providing a steady royalty revenue stream.

FINANCIAL REVIEW

Net revenue in Q2 2011 was $0.7 million, compared with $2.2 million in Q2 2010. Revenue from Lipofen® in Q2 2011 totalled $0.6 million, compared with $2.1 million in Q2 2010. In Q2 2010, we received a one-time sales milestone of $1.0 million. In addition, the Company was still recognizing quarterly revenue on the original up-front licensing payment (received in 2007) from Kowa, as well as a milestone payment received in 2009, both of which were being amortized over several quarters, ending in 2010. Excluding the $1.0 million milestone and the non-cash revenue recognized on these items, royalty revenue from Lipofen® increased by approximately $0.1 million in Q2 2011 compared to Q2 2010.

Gross Research and Development ("R&D") expenditures for Q2 2011 were $1.0 million, a decrease of $2.5 million compared to Q2 2010. The year-over-year decrease reflects reduced spending on the CIP-ISOTRETINOIN clinical study, which was completed in Q2 2011. The reported R&D amount of $0.6 million for Q2 2011 is net of $0.4 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 Q1 2011, the Company reached the contractual cap on the amount of R&D to be 100% reimbursed by its commercial partner for the CIP-ISOTRETINOIN clinical study. Going forward, 50% of the remaining study costs will be borne by Cipher. Our share of these additional R&D costs was $0.4 million during Q2 2011, and we expect the remaining share of the additional R&D costs will be approximately $0.5 to $1.0 million in 2011.

Operating, General and Administrative ("OG&A") expenses for Q2 2011 were $0.6 million, compared to $1.0 million in Q2 2010. As a result of completing the CIP-TRAMADOL ER U.S. distribution agreement in Q2 2011, the Company was able to recover certain OG&A expenses during the quarter that were incurred in prior periods. Net loss in Q2 2011 was $0.5 million ($0.02 per share), compared with net income of $0.8 million ($0.03 per share) in Q2 2010.

The Company's financial position remained solid at quarter end. As at June 30, 2011, Cipher had cash of $8.6 million, compared with $10.3 million as at December 31, 2010. We expect to receive additional milestone payments in 2011, in addition to ongoing royalties from Lipofen and early royalty contribution from our extended-release tramadol product.

OUTLOOK

Looking ahead, we have several key value-driving milestones in the second half of 2011.

- We will launch our extended-release tramadol in the U.S. market with our partner;
- We expect a Health Canada response on our CIP-TRAMADOL ER application and to partner the product for distribution in Canada;
- We plan to complete our FDA and Health Canada submissions for CIP-ISOTRETINOIN;
- We will target distributors in other jurisdictions for our tramadol and isotretinoin products; and
- We will actively look to expand our product portfolio.

We look forward to updating you on our progress at the end of the third quarter.

Sincerely,

Larry Andrews
President and Chief Executive Officer

CIPHER MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 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 June 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 July 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 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. under the trademark ConZip™. CIP-ISOTRETINOIN'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 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, 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 since that time 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 Q2 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 Q2 2011 totalled $0.4 million ($0.7 million on a year-to-date basis). These costs are reflected in research and development expenses. The Company expects its remaining share of the additional R&D costs for the CIP-ISOTRETINOIN Phase III study will be approximately $0.5 to $1.0 million, which costs are expected to be incurred before the end of 2011.

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 will be fulfilled by its partner, Galephar.

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. During Q2 2011, the Canadian Intellectual Property Office issued a patent for CIP-TRAMADOL ER.

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 with additional payments totaling US$1.0 million due upon the first commercial sale of the product. 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. Cipher is responsible for product supply and manufacturing, which will be fulfilled by its partner, Galephar. Vertical plans to launch the product in Q3 2011 under the trade name ConZip™. Vertical's dedicated sales force will comprise 60 representatives at the time of product launch, with plans for further expansion in the first half of 2012.

The Company expects a response from Health Canada concerning regulatory approval in Q3 2011.

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 six month periods ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Licensing revenue	1,402	3,136	(1,734)	(55)

For the three month periods ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Licensing revenue	727	2,218	(1,491)	(67)

For the quarter ended June 30, 2011 the Company recorded licensing revenue of $0.7 million, compared to $2.2 million in Q2 2010.

Revenue from Lipofen in Q2 2011 totalled $0.6 million, a decrease of $1.5 million compared to Q2 2010. In Q2 2010, the Company received a sales milestone of $1.0 million, which was a major contributor to the year-over-year variance in revenue. In addition, in Q2 2010 the Company was still recognizing revenue on the original up-front licensing payment from Kowa (received in 2007) as well as a milestone payment received in 2009, both of which were being amortized over several quarters. Non-cash revenue recognized on these items during Q2 2010 totalled $0.5 million. Revenue for these items was fully recognized by the end of 2010. Excluding these items, royalty revenue from Lipofen showed a slight increase of just under $0.1 million in Q2 2011 compared to Q2 2010.

Revenue from CIP-ISOTRETINOIN was $0.1 million in Q2 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 six months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Research and development	1,125	523	602	115

For the three months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Research and development	578	245	333	136

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 Q2 2011 were $1.0 million, a decrease of $2.5 million compared to Q2 2010. The reduction from prior year reflects reduced spending on the CIP-ISOTRETINOIN clinical study, which was completed during Q2 2011.

The reported R&D expense amount of $0.6 million for Q2 2011 is net of $0.4 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. Reported R&D expense in Q2 2010 was $0.2 million. In Q1 2011, the Company reached the contractual cap on the amount of R&D to be reimbursed 100% by its commercial partner for the CIP-ISOTRETINOIN clinical study. From that point forward, 50% of the remaining study costs are borne by Cipher. The Company's share of these additional R&D costs was $0.4 million during Q2 2011 and $0.7 million for the year to date.

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

For the six months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Operating, general & administrative	1,774	1,941	(167)	(9)

For the three months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Operating, general & administrative	610	1,006	(396)	(39)

OG&A expense in Q2 2011 was $0.6 million compared to $1.0 million in Q2 2010. Under the terms of the CIP-TRAMADOL ER U.S. distribution and supply agreement signed in Q2 2011, the Company is able to recover certain OG&A expenses totalling approximately $0.5 million that were incurred in prior periods.

Amortization of Intangible Assets (in thousands of dollars):

For the six months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Amortization of intangible assets	119	352	(233)	(66)

For the three months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Amortization of intangible assets	60	176	(116)	(66)

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 six months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Interest income	43	18	25	139

For the three months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Interest income	20	12	8	67

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 six months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Income (loss) (in thousands of dollars)	(1,594)	310	(1.904)	nm
Basic and diluted loss per share	(0.07)	0.01	(0.08)	nm

For the three months ended June 30,

	2011	2010	$ change in 2011	% change in 2011
Income (loss) (in thousands of dollars)	(509)	789	(1,298)	nm
Basic and diluted loss per share	(0.02)	0.03	(0.05)	nm

nm – the % change calculation is not meaningful

Loss per share is calculated using the weighted average number of shares outstanding. The loss in Q2 2011 was $0.5 million, or $0.02 per share, compared with net income of $0.8 million, or $0.03 per share, in Q2 2010. Operating results in Q2 2010 were positively impacted by a

commercial milestone of $1.0 million and lower R&D expenses related to the Phase III safety study, compared with Q2 2011. The weighted average number of shares outstanding for the three months ended June 30, 2011 was 24,107,424.

For the six month period ended June 30, 2011, the loss was $1.6 million, or $0.07 per share, compared with net income of $0.3 million, or $0.01 per share, for the corresponding period last year. The weighted average number of shares outstanding for the six months ended June 30, 2011 was 24,095,575.

SUMMARY OF QUARTERLY RESULTS

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

For the six month period ended June 30, 2011 (in accordance with IFRS)

	Q1	Q2	2011 YTD Total
Licensing revenue	675	727	1,402
Research & development (1)	547	578	1,125
Operating, general and administrative	1,164	610	1,774
Depreciation of property and equipment	13	8	21
Amortization of intangible assets	59	60	119
Interest income	23	20	43
Loss	1,085	509	1,594
Loss per share	0.05	0.02	0.07

(1) Reported R&D expense for 2011 is net of provincial tax credits of $65 and reimbursements from Ranbaxy for R&D costs for CIP-ISOTRETINOIN of $705

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	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)	(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 June 30, 2011 was $8.6 million, compared to $10.3 million as at December 31, 2010 and $9.1 million as at March 31, 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 $1.8 million at June 30, 2011, the same amount as at December 31, 2010.

The balance of accounts payable and accrued liabilities was $1.8 million at June 30, 2011 compared to $2.4 million as at December 31, 2010. The reduction in accounts payable and accrued liabilities form December 31, 2010 was 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 $2.2 million at June 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. Cipher expects to incur losses from operations for the near future. R&D expenses are expected to increase, including expenses related to additions of personnel and clinical trials. General and administrative expenses are expected to increase in the future as the Company expands its business development activity, adds infrastructure and incurs additional costs.

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 June 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 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 June 30, 2011 the Company had 24,184,323 common shares issued and outstanding. Subsequent to the end of the quarter, 14,803 common shares were issued under the employee and director share purchase plan, bringing the total number of common shares issued and outstanding to 24,199,126 as of the date of this MD&A.

During the three months ended June 30, 2011, the Company issued 104,445 common shares as a result of the exercise of stock options. No stock options were issued in the three months ended June 30, 2011. Share-based compensation expense in the three months ended June 30, 2011 was $0.1 million, the same amount as in the second quarter of 2010.

CRITICAL ACCOUNTING ESTIMATES

A summary of significant accounting policies is included in Note 3 of the Notes to Interim Financial Statements for the period ended June 30, 2011. 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.

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")

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 4 of the Company's second 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 June 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 June 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 June 30, 2011, the Company had cash of $8.6 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 June 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 Six Months Ended June 30, 2011

(Unaudited)

Cipher Pharmaceuticals Inc.
Balance Sheets

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

	Note	June 30, 2011	December 31, 2010	January 1, 2010
		$	$	$
ASSETS				
Current assets				
Cash		8,573	10,328	9,006
Accounts receivable		1,830	1,808	967
Prepaid expenses and other assets		207	465	457
Loan receivable		-	-	800
		10,610	12,601	11,230
Property and equipment, net		35	50	86
Intangible assets, net	6	3,403	3,522	3,507
		14,048	16,173	14,823
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	7	1,829	2,440	1,570
Current portion of deferred revenue		643	567	1,956
		2,472	3,007	3,526
Deferred revenue		1,568	1,692	329
		4,040	4,699	3,855
SHAREHOLDERS' EQUITY				
Share capital	8	50,067	49,977	49,948
Contributed surplus	4	32,928	32,890	32,585
Deficit	4	(72,987)	(71,393)	(71,565)
		10,008	11,474	10,968
		14,048	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 six month periods ended June 30, 2011 and 2010
(in thousands of Canadian dollars, except per share data - unaudited)

	Note	Three months		Six months	
		June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
		$	$	$	$
Revenues					
Licensing revenue		727	2,218	1,402	3,136
Expenses					
Research and development		578	245	1,125	523
Operating, general and administrative		610	1,006	1,774	1,941
Depreciation of property and equipment		8	14	21	28
Amortization of intangible assets		60	176	119	352
Interest income		(20)	(12)	(43)	(18)
	9	1,236	1,429	2,996	2,826
Income (loss) and comprehensive income (loss) for the period	4	(509)	789	(1,594)	310
Basic and diluted earnings (loss) per share	10	(0.02)	0.03	(0.07)	0.01

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

Cipher Pharmaceuticals Inc.
Statements of Changes in Equity

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

	Share Capital	Contributed Surplus	Deficit	Total Shareholders' Equity
	$	$	$	$
Balance as at January 1, 2011	49,977	32,890	(71,393)	11,474
Loss and comprehensive loss for the period	-	-	(1,594)	(1,594)
Exercise of stock options	90	(43)	-	47
Share-based compensation expense	-	81	-	81
Balance as at June 30, 2011	50,067	32,928	(72,987)	10,008
Balance as at January 1, 2010	49,948	32,585	(71,565)	10,968
Income and comprehensive income for the period	-	-	310	310
Exercise of stock options	29	(14)	-	15
Share-based compensation expense	-	170	-	170
Balance as at June 30, 2010	49,977	32,741	(71,255)	11,463

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

Cipher Pharmaceuticals Inc.
Statements of Cash Flows

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

	Note	Three months June 30, 2011	Three months June 30, 2010	Six months June 30, 2011	Six months June 30, 2010
		$	$	$	$
Cash provided by (used in)					
Operating activities					
Income (loss) for the period		(509)	789	(1,594)	310
Items not affecting cash:					
Depreciation of property and equipment		8	14	21	28
Amortization of intangible assets	6	60	176	119	352
Share-based compensation expense		53	84	81	170
		(388)	1,063	(1,373)	860
Changes in non-cash operating items:					
Accounts receivable		(238)	550	(22)	(1,884)
Prepaid expenses and other assets		158	185	258	304
Accounts payable and accrued liabilities		(247)	618	(611)	1,214
Deferred revenue		96	(895)	(48)	344
Net cash generated from (used in) operating activities		(619)	1,521	(1,796)	838
Investing activities					
Proceeds from loan receivable		-	-	-	800
Purchase of property and equipment		(2)	(13)	(6)	(14)
Acquisition of intangible rights		-	(335)	-	(335)
Net cash generated from (used in) investing activities		(2)	(348)	(6)	451
Financing activities					
Proceeds from exercise of stock options		47	15	47	15
Increase (Decrease) in cash		(574)	1,188	(1,755)	1,304
Cash as at beginning of period		9,147	9,122	10,328	9,006
Cash as at end of period		8,573	10,310	8,573	10,310

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

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 4, 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 4 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 July 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. Note 4 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these interim financial statements.

3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these interim financial statements are described below.

Basis of measurement
The financial statements have been prepared under the historical cost convention.

Translation of foreign currencies
The financial statements are presented in Canadian dollars, which is the Company's functional currency. 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 income (loss) for the period.

Critical accounting estimates and judgments
The Company makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that most significantly affect the Company's financial statements. These estimates and judgments have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

(i) Estimated useful lives and valuation of intangible assets - management estimates the useful lives of intangible assets based on the period during which the assets are expected to be available for use and also estimates the recoverability to assess if there has been an impairment. The amounts and timing of recorded expenses for amortization and impairments of intangible assets for any period are affected by these estimates. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence, generic threats and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's intangible assets in the future.

(ii) Revenue recognition - management evaluates the multiple elements and units of accounting which are included within certain licensing and distribution agreements. The recognition of revenue on up-front licensing payments and pre-commercialization amounts are over the estimated period that the Company maintains substantive contractual obligations. The estimate periods are reviewed at least annually and are updated if expectations change as a result of licensing partner interactions, product commercial obsolescence or other limiting factors. It is possible that these factors may cause significant changes in the Company's recognition of revenue in the future.

(iii) 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.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. The Company does not have any instruments classified in this category. Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of operations. Gains and losses arising from changes in fair value are presented in the statement of operations in the period in which they arise.

(ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not have any instruments classified in this category. Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of operations and are included in other gains and losses.

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise cash, accounts receivable and loan receivable, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities. Accounts payable and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payable are measured at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss. Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Cash

Cash includes deposits held with banks.

Accounts receivable

Accounts receivable consist of amounts due from licensing partners for royalties and product sales in the normal course of business and other amounts such as interest receivable and tax credits receivable.

Prepaid expenses and other assets

Prepaid expenses consist of amounts paid in advance for items that have future value to the Company, such as insurance policy payments, U.S. Food and Drug Administration fees, data base subscription fees and other items paid in advance. Other assets consist of lease and utility deposits.

Property and equipment

Property and equipment are recorded at historical cost less accumulated depreciation and accumulated impairment losses. The useful lives of property and equipment are reviewed at least once per year. Depreciation is computed using the straight-line method, using the following estimated useful lives of the assets or lease terms:

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

Intangible assets

Intangible assets consist of marketing and other rights relating to products and are recorded at cost less accumulated amortization and accumulated impairment losses. Intangible assets have a finite life and are amortized using the straight-line method over their estimated period of useful life. The useful lives of the intangible assets are reviewed at least once per year. Amortization commences on the earlier of the date of regulatory (generally, U.S. Food and Drug Administration) 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.

Impairment of non-financial assets
Non-financial assets, which include property and equipment and intangible assets, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized when the carrying amount of a non-financial asset exceeds the sum of the estimated present value of the expected future cash flows from the non-financial asset. The Company evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

Accounts payable and accrued liabilities
Accounts payable are obligations to pay for goods and services that have been acquired in the ordinary course of business from suppliers and are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Deferred revenue
Deferred revenue consists of amounts received from licence partners in advance of revenue recognition. Amounts expected to be recognized within one year or less are classified as current liabilities with the balance being classified as non-current liabilities.

Share capital
Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

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.

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 and contractual reimbursements from development partners, are expensed in the periods in which they are incurred.

Income taxes
Income tax comprises current and deferred tax. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. Deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered. Tax on income for interim periods is accrued using the tax rate that would be applicable to expected total annual earnings.

Share-based compensation
The fair value of options granted to employees and directors is estimated on the date of the grants using the Black-Scholes option pricing model. Stock options vest over four years (25% per year), expire after ten years and can only be settled for shares. Each tranche in an award is considered as a separate award with its own vesting period and grant date fair value. Share-based compensation expense is recognized over the tranche's vesting period based on the number of awards expected to vest, by increasing contributed surplus. The number of awards expected to vest is reviewed annually, with any impact being recognized immediately. Share-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.

Earnings per share
Basic earnings per share ("EPS") is calculated using the treasury stock method, by dividing the net income (loss) for the period by the weighted number of common shares outstanding during the period. Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Accounting standards issued but not yet applied

International Financial Reporting Standard 9, *Financial Instruments* ("IFRS 9")

IFRS 9 was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement,* except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

4 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 June 30, 2010	As at Jan 1, 2010
As reported under Canadian GAAP	$ (71,192)	$ (71,017)	$ (71,248)
Increase in deficit for:			
Share-based compensation expense - IFRS 2	(201)	(238)	(317)
As reported under IFRS	$ (71,393)	$ (71,255)	$ (71,565)

Contributed Surplus

	As at Dec 31, 2010	As at June 30, 2010	As at Jan 1, 2010
As reported under Canadian GAAP	$ 32,689	$ 32,503	$ 32,268
Increase in contributed surplus for:			
Share-based compensation expense - IFRS 2	201	238	317
As reported under IFRS	$ 32,890	$ 32,741	$ 32,585

Comprehensive Income (loss)

	Year Ended Dec 31, 2010	Six Months Ended June 30, 2010	Three Months Ended June 30, 2010
As reported under Canadian GAAP	$ 56	$ 231	$ 743
Increase in comprehensive income for:			
Share-based compensation expense - IFRS 2	116	79	46
As reported under IFRS	$ 172	$ 310	$ 789

Operating, general and administrative expense

	Year Ended Dec 31, 2010	Six Months Ended June 30, 2010	Three Months Ended June 30, 2010
As reported under Canadian GAAP	$ 3,895	$ 2,020	$ 1,052
Decrease in operating, general and administrative expense for:			
Share-based compensation expense - IFRS 2	(116)	(79)	(46)
As reported under IFRS	$ 3,779	$ 1,941	$ 1,006

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 $79 for the six months ended June 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:

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010	Year Ended Dec 31, 2010
Salaries and short-term employee benefits, including bonuses	$ 636	$ 730	$ 1,345
Directors fees	154	147	275
Share-based compensation expense	73	152	287
	$ 863	$ 1,029	$ 1,907

5 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
Cash - the Company's cash balance is on deposit with a Canadian chartered bank that has a DBRS rating of "AA" for deposits and senior debt.
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. The accounts receivable balance is concentrated between two licensing partners. Both have been partners with the Company for over two years, with no defaults in the past. As of June 30, 2011, no accounts receivable balances were impaired or past due.

5 RISK MANAGEMENT (continued)

(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 $1,862 as at June 30, 2011 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 June 30, 2011 includes a total of US$1,753 and accounts payable and accrued liabilities includes a total of US$1,082. A 10% change in the US/CDN exchange rate on the net June 30, 2011 balance would have had a $67 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.

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 $627 (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. After product-related expenses are deducted and after the recovery of Cipher's investment in the Galephar shares, 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 June 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 six month period ended June 30, 2011				
Opening net book value	$ -	$ 1,068	$ 2,454	$ 3,522
Additions	-	-	-	-
Amortization	-	(119)	-	(119)
Net book value	$ -	$ 949	$ 2,454	$ 3,403
As at June 30, 2011				
Cost	$ 2,332	$ 1,579	$ 2,454	$ 6,365
Accumulated amortization	(2,332)	(630)	-	(2,962)
Net book value	$ -	$ 949	$ 2,454	$ 3,403

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

7 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	As at June 30, 2011	As at Dec 31, 2010
Trade accounts payable	$ 1,221	$ 1,580
Accrued liabilities	608	860
	$ 1,829	$ 2,440

8 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 June 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
Balance outstanding - June 30, 2011	24,184	50,067

Stock option plan

The following is a summary of the changes in the stock options outstanding from January 1, 2010 to June 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
Balance outstanding - June 30, 2011	1,769	2.24

At June 30, 2011, 1,240,623 options were fully vested and exercisable (1,054,560 at June 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.

9 EXPENSES BY NATURE

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Employees salaries and directors fees	$ 1,018	$ 1,015
Share-based compensation	81	170
Depreciation and amortization	140	380
Professional fees	484	343
Contract research	705	-
Other expenses, net of interest income	568	918
	$ 2,996	$ 2,826

10 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 six month periods ended June 30, 2011 was 24,107,424 and 24,095,575 respectively (for the three and six month periods ended June 30, 2010 respectively 24,071,087 and 24,063,027).

As the Company had a loss for the three and six month periods ended June 30, 2011, 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 a share for the three and six month periods ended June 30, 2010 is not significant.

11 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".

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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