There's a lot
in this.

Before this single pill gets to the pharmacy, it requires:

- Identification of product opportunities
- Due diligence and in-licensing
- Pre-clinical studies
- Clinical and commercial manufacturing
- Multiple clinical trials
- Significant regulatory work
- Intellectual property know-how
- Finding great partners

And that's not all. At Cipher, we have worked hard to build the capabilities necessary to find, develop and commercialize improved versions of current drugs. We believe we have a valuable foundation and one that is built for sustainable success.

54 Clinical Trials	5 New Drug Applications	3 Licensing Partnerships
15 Experienced Staff	2 Final FDA Approvals	1 Growing Royalty Stream

That's a lot.

Letter to Shareholders

During the second quarter, we saw continued growth in weekly Lipofen® prescriptions from our U.S. distributor, Kowa Pharmaceuticals America. Net sales and our royalty payments reached new records, with total prescriptions growing by 14% over the previous quarter. Recently, Kowa reached a cumulative sales milestone for Lipofen, which triggered a US$1.0 million payment to Cipher. This continued growth has been driven by increased promotion and sales force expansion at Kowa. In addition, Kowa increased its pricing, effective July 1, 2010.

As planned, Kowa launched its pitavastatin product, LIVALO®, in June. LIVALO and Lipofen complement one another in the treatment of patients with high cholesterol. In fact, over 50% of all Lipofen prescriptions are used in combination with other lipid-lowering agents. We are hopeful that a combination of the increased sales force, the complementary nature of the two products, and an increase in royalty payments due to shifting to second detail position will offset the effect of no longer being in first position in each physician call.

During the second quarter, we reached a very important milestone with final FDA approval of CIP-TRAMADOL ER, our extended-release tramadol product. Our second FDA approval reflects a significant amount of effort, dedication and perseverance from our team, who had to navigate numerous clinical and regulatory hurdles along the way. The path to commercial launch was made clearer when the United States Court of Appeals upheld the lower court's original decision on patent infringement litigation initiated by Purdue Pharma Products L.P. against Par Pharmaceuticals Companies, Inc. relating to Ultram® ER, the reference product in our new drug application. This decision confirms our long-held view that these patents were invalid, and further mitigates any remaining risk of patent litigation on these patents against our product.

We are currently preparing for U.S. commercial launch of CIP-TRAMADOL ER, which includes securing a marketing partner and finalizing the manufacturing requirements for the product. We are targeting Q1 2011 for our commercial launch. We continue to advance our discussions with prospective out-licensing partners, both for the U.S. and Canada.

In Q2 2010, we continued to make good progress with the pivotal Phase III safety study of CIP-ISOTRETINOIN, our acne medication. From 176 patients at year end, we are now at more than 75% enrollment with in excess of 700 patients currently on medication. This puts us on pace to complete enrollment by the end of Q3 2010, with study completion expected in the first half of 2011.

Financial Review

Net revenue in Q2 2010 was $2.2 million, compared with $0.7 million in Q2 2009. The improved performance reflects a continuing trend of higher royalty revenue for Lipofen during the quarter, as well as the one-time US$1 million commercial milestone payment.

Gross Research and Development ("R&D") expenditures for Q2 2010 rose to $3.5 million, compared with $1.5 million in Q2 2009, driven by the CIP-ISOTRETINOIN clinical study. The reported R&D expenditure amount of $0.2 million for Q2 2010 is net of $3.3 million of reimbursed expenses by our U.S. marketing partner. Operating, General and Administrative expenses for Q2 2010 were $1.1 million, consistent with the prior year.

For the three months ended June 30, 2010, the Company recorded net income of $0.7 million ($0.03 per basic and diluted share), compared with a loss of $0.8 million ($0.03 per basic and diluted share) for Q2 2009.

Our financial position remained solid at quarter-end. As at June 30, 2010, Cipher had cash of $10.3 million, compared with $9.0 million as at December 31, 2009, and continued to have no debt.

Looking ahead, we have several priorities in 2010.

- Working closely with Kowa as it expands its sales force further and we see the full impact of this increased sales and marketing effort.
- Completing trial enrollment for the CIP-ISOTRETINOIN Phase III safety study;
- Securing a marketing partner for our extended-release tramadol and preparing for commercialization; and
- Leveraging our current FDA approvals in other targeted jurisdictions and expanding our pipeline with novel early stage products.

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

Sincerely,

Larry Andrews
President and Chief Executive Officer

CIPHER MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") for the three months ended June 30, 2010. This document should be read in conjunction with the unaudited financial statements and the accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information about the Company, including the audited financial statements, MD&A and Annual Information Form for the year ended December 31, 2009, is available on SEDAR at www.sedar.com.

The discussion and analysis within this MD&A are as of July 27, 2010.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS:

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

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

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

OVERVIEW:

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

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

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

CIP-FENOFIBRATE is a novel patented formulation of the active ingredient fenofibrate, which is used in the treatment of hyperlipidemia, a cholesterol disorder. Hyperlipidemia is a condition characterized by high levels of low-density lipoprotein ("LDL") cholesterol and/or triglycerides (a type of fat found in the blood). Fenofibrate is known to lower LDL cholesterol and triglycerides and increase high-density lipoproteins ("HDL"), known as "good cholesterol". Fibrates have proven to be superior in lowering triglycerides and raising HDL levels. CIP-FENOFIBRATE targets a large and growing market. According to IMS, the hyperlipidemia market in the U.S. alone exceeds US$18 billion and is made up of three primary groups of drugs: statins, fibrates and the prescription DHA/EPA market. The use of fenofibrates has escalated rapidly in recent years, with increased patient demand expected to continue. The market for existing fenofibrate formulations in the U.S. exceeded US$2 billion during 2009, with prescriptions growing 15.2% 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 exceeded $0.4 billion in 2009, and if converted into brand dollars, is estimated to be more than US$1.0 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, 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 $0.2 billion which only represents 4.2% of the total tramadol immediate release and extended release prescription market. The total tramadol market exceeded 27 million prescriptions in 2009 with an annual growth rate in prescriptions of 6.2%.

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"). To date, Lipofen has been the lead product for Kowa as it seeks to build its presence in the important primary care space.

The agreement with Kowa is for a period of ten years and they have the right to extend the term for two additional two-year periods. Under the terms of the agreement, Cipher received a US$2 million up-front licensing payment and could receive additional milestone payments of up to US$20 million if certain net sales targets are achieved. Cipher also receives a royalty on a percentage of net sales, which escalates from the mid-teens to mid-twenties based on annual sales achieved and the level of promotional effort by Kowa. These payments are reflected in Cipher's net revenue, which incorporates direct product-related expenses and amounts due to Galephar, Cipher's technology partner. Over the term of the agreement, after product-related expenses are deducted and including payments to Galephar, Cipher anticipates that it will retain approximately 50% of net revenue.

Lipofen was launched in the U.S. market in late 2007, and monthly prescriptions have shown steady growth since that time as Kowa increases coverage of the primary care physicians in its targeted regions and expands its sales force. Kowa's sales force grew to approximately 250 at the end of the second quarter of 2010 to support the recent launch of their complementary product, LIVALO. During the second quarter of 2010, the Company reached a cumulative net sales milestone for Lipofen. Achieving this target triggered a US$1.0 million milestone payment from Kowa. Starting in Q3 2010, Lipofen will be detailed in second position (after Livalo) to U.S. physicians.

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 initial upfront milestone payment of US$1 million. The agreement includes additional pre- and post-commercialization milestone payments of up to US$23 million, contingent upon the achievement of certain milestone targets. Once the product is successfully commercialized, Cipher will also receive a royalty percentage in the mid-teens on net sales. In addition, RPI will reimburse Cipher for the costs associated with any remaining clinical studies required to obtain FDA approval, up to a predetermined cap. Any additional development costs associated with initial FDA approval will be shared equally. Cipher is responsible for all product development activities, including management of the clinical studies required by the FDA to secure NDA approval. Cipher is also responsible for product supply and manufacturing, which would be fulfilled by its partner, Galephar Pharmaceutical Research. After product-related expenses are deducted and after the recovery of Cipher's investment in the

preferred shares of Galephar, approximately 50% of all net revenue received by Cipher under the agreement will be paid to Galephar.

In Q4 2008, an important milestone was achieved when a product patent was issued by the United States Patent and Trademark Office for CIP-ISOTRETINOIN. The patent includes claims related to the reduced food effect of CIP-ISOTRETINOIN relative to currently marketed formulations.

In the second quarter of 2009, Cipher finalized the protocol with the FDA for the Phase III safety trial under a Special Protocol Assessment ("SPA"). The study is expected to enroll more than 800 patients and be conducted over an 18-month period at 50 sites in the U.S. and Canada. The study is a randomized double-blinded trial comparing the safety profile of CIP-ISOTRETINOIN to an FDA-approved, commercially available isotretinoin product. The study, which began early in the fourth quarter of 2009, is progressing well. During the first quarter of 2010, the study reached the mid-point of the enrolment period, which triggered a US$2 million payment from Ranbaxy. At the end of the second quarter of 2010, over 700 patients had been enrolled in the study.

CIP-TRAMADOL ER

During the second quarter of 2008, Cipher submitted a revised NDA to the FDA for CIP-TRAMADOL ER. After considering feedback from the FDA appeal process and the results of the additional statistical sensitivity analysis of existing data suggested by the FDA, Cipher and its advisors concluded that submitting the revised NDA provided the most expeditious path to final regulatory approval. Cipher's revised NDA includes data from additional pharmacokinetic studies conducted by the Company comparing CIP-TRAMADOL ER to Ultram® ER. Cipher's revised NDA received tentative FDA approval in February 2009.

In Q3 2009, the Company filed a Paragraph IV Certification with the FDA, which states that the relevant patent listed in the FDA's Orange Book for Ultram® ER is invalid, unenforceable, and/or will not be infringed by the manufacture or sale of Cipher's drug product. Subsequently, the Company announced that Purdue Pharma Products L.P. ("Purdue") and Napp Pharmaceutical Group Ltd. filed a complaint against Cipher in the United States District Court for the Eastern District of Virginia, for alleged infringement of two U.S. patents, specifically patent number 6,254,887 and patent number 7,074,430. In Q1 2010, the Company announced that a final summary judgment had been entered in favour of Cipher in relation to the above litigation. The judgment terminated any further stay of FDA approval of Cipher's NDA under the applicable provisions of the Hatch-Waxman Act. The final judgment holds that the patents-in-suit are invalid for obviousness based on a prior decision of the United States District Court for the District of Delaware, dated August 14, 2009, invalidating the Orange Book-listed patents for Ultram® ER in litigation filed by Purdue against Par Pharmaceutical, Inc.

In May 2010, Cipher announced that the FDA has approved CIP-TRAMADOL ER, the Company's extended-release tramadol product, for the treatment of moderate to moderately severe chronic pain in adults. Also during Q2 2010, the United States Court of Appeals upheld the lower court's original decision on patent infringement litigation initiated by Pharma Products L.P against Par Pharmaceutical Companies, Inc. relating to Ultram® ER, the reference product in Cipher's New Drug Application for CIP-TRAMADOL ER. This affirmed the invalidity of the asserted claims of the Orange Book-listed patents for Ultram® ER. These are the same patents that were originally asserted against Cipher and for which Cipher was granted summary judgment in January 2010. This decision confirms Cipher's long-held view that these patents are invalid and further mitigates any remaining risk of patent litigation on these patents against CIP-TRAMADOL ER. Cipher is currently preparing for the U.S. commercial launch of the product, which includes securing a marketing partner and finalizing commercial manufacturing requirements. The Company is targeting Q1 2011 for commercial launch.

NEW PRODUCTS AND OUT-LICENSING ACTIVITIES

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

REVIEW OF OPERATING RESULTS:

Revenues (in thousands of dollars):

For the six month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Licensing revenue	3,136	1,280	1,856	145

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Licensing revenue	2,218	678	1,540	227

For the quarter ended June 30, 2010 the Company realized licensing revenue of $2.2 million compared to $0.7 million in Q2 2009.

Revenue from Lipofen in Q2 2010 totalled $2.1 million, an increase of $1.5 million over 2009. The increase was primarily a result of the achievement of a commercial milestone for US$1 million. Under the terms of the agreement with Kowa, the milestone is earned when cumulative net sales reach US$25 million. This was achieved during the second quarter and the full amount has been reflected in revenue. The balance of the increase in revenue compared to the second quarter of 2009 was related to increased royalty revenue, reflecting continued market penetration by Lipofen as Kowa increases the sales and promotion effort behind the product.

Revenue from CIP-ISOTRETINOIN was $0.1 million in Q2 2010, the same amount as Q2 2009, which relates to revenue recognized on the Company's share of the milestone payments received from Ranbaxy to date.

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

Research and Development Expense (in thousands of dollars):

For the six month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Research and development	523	454	69	15

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Research and development	245	225	20	9

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 by Ranbaxy for the CIP-ISOTRETINOIN Phase III clinical study during the quarter and refundable

provincial tax credits. Gross R&D expenditures during Q2 2010 were $3.5 million, which represents an increase of $2.0 million compared to Q2 2009, driven by the CIP-ISOTRETINOIN clinical study. The reported R&D expenditure amount of $0.2 million for Q2 2010 is net of $3.3 million ($1.3 million in Q2 2009) of reimbursed expenses from Cipher's marketing partner.

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

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

For the six month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Operating, general & administrative	2,020	2,046	(26)	(1)

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Operating, general & administrative	1,052	1,057	(5)	(1)

OG&A expense in Q2 2010 was $1.1 million, the same amount as the second quarter of 2009.

Amortization of Intangible Assets (in thousands of dollars):

For the six month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Amortization of intangible assets	352	377	(25)	(7)

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Amortization of intangible assets	176	189	(13)	(7)

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.

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 month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Interest income	18	73	(55)	(75)

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Interest income	12	27	(15)	(56)

Interest is earned on the Company's cash balance. In 2009, imputed interest was recorded related to the loan receivable; however, the balance of the loan was received in January 2010 and as a result interest income was lower in Q2 of 2010 than in the comparable period last year.

Provision for Income Taxes:

The Company has approximately $22 million of future income tax assets, for which a valuation allowance has been recorded against the entire balance. These assets consist of non-capital loss carry forwards, intangible assets and R&D expenditures which are available to reduce taxable income in future years. The Company also has approximately $2.8 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 per Share:

For the six month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Income (loss) (in thousands of dollars)	231	(1,561)	1,792	nm
Basic and diluted earnings (loss) per share	0.01	(0.06)	0.07	nm

For the three month periods ended June 30,

	2010	2009	$ change in 2010	% change in 2010
Income (loss) (in thousands of dollars)	743	(784)	1,527	nm
Basic and diluted earnings (loss) per share	0.03	(0.03)	0.06	nm

Net income for the quarter ended June 30, 2010 was $0.7 million, or $0.03 per share, compared with a loss of $0.8 million, or $0.03 per share, for the quarter ended June 30, 2009. The improved performance was due to the achievement of a US$1 million milestone for Lipofen as well as higher royalty revenue for the product during the quarter. For the six-month period ended June 30, 2010, net income was $0.2 million, or $0.01 per share, compared with a loss of $1.6 million, or $0.06 per share, for the corresponding period last year. The improved performance for the six-month period was a result of the same factors outlined for the second quarter.

SUMMARY OF QUARTERLY RESULTS:

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

For the six month period ended June 30, 2010

	Q1	Q2	2010 YTD Total
Licensing revenue	918	2,218	3,136
Research & development (1)	278	245	523
Operating, general and administrative	968	1,052	2,020
Amortization of property and equipment	14	14	28
Amortization of intangible assets	176	176	352
Interest income	6	12	18
Net Income (loss)	(512)	743	231
Earnings (loss) per share	(0.02)	0.03	0.01

(1) Reported R&D expense for 2010 is net of provincial tax credits of $132 and reimbursements from Ranbaxy for R&D expenditures for CIP-ISOTRETINOIN of $7,050.

For the year ended December 31, 2009

	Q1	Q2	Q3	Q4	2009 Total
Licensing revenue	602	678	1,067	832	3,179
Research & development (2)	229	225	247	255	956
Operating, general and administrative	989	1,057	1,157	1,049	4,252
Amortization 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)

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

For the year ended December 31, 2008

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

(3) Reported R&D expenses for 2008 are net of provincial tax credits of $440 and reimbursements from Ranbaxy for R&D expenditures for the CIP-ISOTRETINOIN Phase III trial of $496.

LIQUIDITY AND CAPITAL RESOURCES:

The cash balance at June 30, 2010 was $10.3 million compared to $9.0 million as at December 31, 2009 and $9.1 as at March 31, 2010. 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 accounts receivable balance was $2.9 million at June 30, 2010 compared to $1.0 million as at December 31, 2009. The increase is primarily due to the achievement of the cumulative net sales milestone for Lipofen, which resulted in a billing of US$1 million at the end of June as well as the increased commercial activity during the period.

The balance of accounts payable and accrued liabilities was $2.8 million at June 30, 2010, compared to $1.6 million as at December 31, 2009. The increase is in line with the higher level of commercial activity during the period and the increased level of activity for the CIP-ISOTRETINOIN Phase III clinical study.

Deferred revenue relates to amounts received in advance of revenue recognition. The balance of $2.6 million at June 30, 2010 includes the Company's share of milestone payments received under the Ranbaxy and Kowa distribution and supply agreements, net of revenue recognized to date. The deferred revenue balance at December 31, 2009 was $2.3 million.

The development of pharmaceutical products is a process that requires significant investment. 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, 2010, there are no capital lease contractual obligations. The only significant operating lease contractual obligation is the Company's office location, which expires in 2012.

SHARE CAPITAL:

The Company is authorized to issue an unlimited number of shares. At June 30, 2010, and at the date of this MD&A, the Company had 24,079,878 common shares issued and outstanding.

Stock-based compensation expense during the three months ended June 30, 2010 was $0.1 million, compared to $0.2 million in the second quarter of 2009.

During the three months ended June 30, 2010, the Company issued 25,000 shares as a result of the exercise of stock options. No stock options were exercised in 2009.

No stock options were issued in the three months ended June 30, 2010.

CRITICAL ACCOUNTING ESTIMATES:

A summary of significant accounting policies is included in Note 1 of the Notes to Financial Statements for the year ended December 31, 2009. Critical accounting estimates require management to make certain judgments and estimates, which may differ from actual results. Accounting estimates are based on historical experience and other factors that management

believes to be reasonable under the time frame and circumstances. Changes in management's accounting estimates can have a material impact on the financial results of the Company. The Company's critical accounting estimates are described below.

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

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

FINANCIAL INSTRUMENTS:

Credit Risk Exposure: The only financial instrument that is potentially subject to credit risk is 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 $1.1 million.

INTERNATIONAL FINANCIAL REPORTING STANDARDS:

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

The Company has established an IFRS changeover plan. The first phase of the conversion process was the diagnostic review phase. This was completed in 2009 and the results of the review were presented to the Board of Directors. The main conclusions of the diagnostic review were as follows:

- The current accounting system is adequate for the transition to IFRS
- There is no need to maintain dual recordkeeping during 2010. The information required for the presentation of comparative financial information will be available from the current system.
- None of the Company's current contracts and employment arrangements are impacted by the upcoming changeover to IFRS

The next phase of the changeover plan is the detailed planning and implementation phase and the Company will be proceeding with these phases over the course of 2010.

Status of the IFRS Changeover Plan

The following is a summary of the status of the key activities in the Company's IFRS changeover plan as at June 30, 2010. Additional information will be provided as we progress towards the changeover date of January 1, 2011.

IFRS Impact Area	Key Activities	Current Status
Accounting policies and financial statement preparation	Identify differences between Canadian GAAP and IFRS accounting policies that impact the Company Selection of IFRS 1 accounting policy choices Identify changes required in note disclosure	Differences identified to date are summarized below IFRS 1 accounting policy choices have been made The review is ongoing
Information technology and data systems	Identify changes required to financial systems Determine and implement processes for capturing financial information under IFRS in 2010 for comparative information	Completed – no changes required Completed – processes are implemented
Internal control over financial reporting ("ICFR")/Disclosure controls and procedures ("DC&P")	Determine and implement processes for capturing financial information under IFRS in 2010 for comparative information	The assessment is done as changes in accounting policies and financial statement preparation are identified
Training and communication	Education of management and Audit Committee External communication regarding IFRS status	Key individuals involved in the changeover process have been trained Included in 2009 year-end MD&A and quarterly MD&As in 2010
Business activities	Identify impact of changeover on contractual arrangements and employee compensation plans	Review of contracts and compensation plans has been completed and there is no impact. New contracts entered into will accommodate IFRS changes.

Differences between Canadian GAAP and IFRS

A detailed review of the major differences between Canadian GAAP and IFRS has been undertaken by the Company. At this point in time, only the item summarized below has been identified as having a significant impact on the Company's financial statements. The summary below is intended to highlight the areas believed to be of most significance and is not intended to be a complete and exhaustive list of all expected changes. In the period leading up to conversion, the International Accounting Standards Board will continue to issue new accounting standards and as a result, the final impact of IFRS on the Company's financial statements can only be accurately determined once all the IFRS applicable at the conversion date of January 1, 2011 are known. Readers are cautioned that the disclosed impacts of IFRS on financial reporting are estimates and may be subject to change.

Stock-based Compensation Expense: In certain circumstances, IFRS requires a different measurement of stock-based compensation expense related to stock options than current Canadian GAAP. The Company currently recognizes stock-based compensation expense for

options granted over the overall vesting period (ie. options granted vest over four years, stock compensation expense is recognized over that period). Under IFRS 2, where stock options are granted and vest in instalments over a period, each instalment should be treated as a separate stock option grant. The estimated impact of recognizing stock-based compensation expense by instalment as at January 1, 2010 is a reduction in retained earnings of $0.3 million and an increase in contributed surplus of $0.3 million. The estimated impact on 2010 results is a reduction in stock-based compensation expense of $0.1 million.

BUSINESS RISKS:

Financial: As at June 30, 2010, the Company had cash of $10.3 million. The Company expects these funds will be sufficient to fund current product development and operating costs. The Company expects to incur losses from continuing operations for the near future.

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

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

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

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

- The Company's partners may be pursuing alternative technologies or developing alternative products, either on their own or in collaboration with others, that may be competitive with the products on which they are collaborating with the Company, which could affect their commitment to the Company's product development efforts;
- The Company's technology partners may not be able to adequately supply its products in commercial quantities, which would adversely affect revenues;
- Reductions in marketing or sales efforts or a discontinuation of marketing or sales of the Company's products by its commercial partners may reduce future revenues, which will be based on a percentage of net sales by these partners; and
- The Company's partners may terminate their collaborations with the Company, which could make it difficult for the Company to attract new partners or adversely affect how the Company is perceived in the business and financial communities.

The development of pharmaceutical products is a process that requires large investments and can take years to complete. Projects can be abandoned along the way or regulatory authorities can refuse to approve new products. With respect to projects the Company initiates, the

Company will attempt to minimize risk through the judicious selection of product candidates and by focusing on improving products that have already been marketed.

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

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

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

DISCLOSURE CONTROLS AND PROCEDURES:

There have been no changes in the Company’s internal control over financial reporting during the most recent interim period ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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

	As at June 30, 2010	As at December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 10,310	$ 9,006
Accounts receivable (note 2)	2,851	967
Prepaid expenses and other current assets	153	457
Loan receivable (note 3)	-	800
	13,314	11,230
Property and equipment, net	72	86
Intangible assets, net (note 4)	3,490	3,507
	$ 16,876	$ 14,823
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 2,784	$ 1,570
Current portion of deferred revenue	1,405	1,956
	4,189	3,526
Deferred revenue	1,224	329
	5,413	3,855
SHAREHOLDERS' EQUITY		
Share capital (note 5)	49,977	49,948
Contributed surplus (note 5)	32,503	32,268
Deficit	(71,017)	(71,248)
	11,463	10,968
	$ 16,876	$ 14,823

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

Cipher Pharmaceuticals Inc.

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

	For the three months ended June 30		For the six months ended June 30	
	2010	**2009**	**2010**	**2009**
Revenues				
Licensing revenue	**$** 2,218	**$** 678	**$** 3,136	**$** 1,280
Expenses				
Research and development	245	225	523	454
Operating, general and administrative	1,052	1,057	2,020	2,046
Amortization of property and equipment	14	18	28	37
Amortization of intangible assets	176	189	352	377
Interest income	(12)	(27)	(18)	(73)
	1,475	1,462	2,905	2,841
Income (loss) and comprehensive income (loss) for the period	**$** 743	**$** (784)	**$** 231	**$** (1,561)
Basic and diluted earnings (loss) per share (note 6)	**$** 0.03	**$** (0.03)	**$** 0.01	**$** (0.06)

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

Cipher Pharmaceuticals Inc.

Unaudited Statements of Deficit
(in thousands of dollars)

	For the three months ended June 30		For the six months ended June 30	
	2010	**2009**	**2010**	**2009**
Deficit, beginning of period	**$** (71,760)	**$** (69,310)	**$** (71,248)	**$** (68,533)
Income (loss) for the period	743	(784)	231	(1,561)
Deficit, end of period	**$** (71,017)	**$** (70,094)	**$** (71,017)	**$** (70,094)

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

Cipher Pharmaceuticals Inc.

Unaudited Statements of Cash Flows
(in thousands of dollars)

	For the three months ended June 30		For the six months ended June 30	
	2010	**2009**	**2010**	**2009**
Cash provided by (used in)				
Operating activities				
Income (loss)	**$** 743	**$** (784)	**$** 231	**$** (1,561)
Items not affecting cash				
Amortization of property and equipment	14	18	28	37
Amortization of intangible assets	176	189	352	377
Stock-based compensation expense	130	164	249	325
Imputed interest	-	(19)	-	(47)
	1,063	(432)	860	(869)
Net change in non-cash operating items	458	968	(22)	137
	1,521	536	838	(732)
Investing activities				
Proceeds from loan receivable	-	-	800	612
Purchase of property and equipment	(13)	(5)	(14)	(5)
Acquisition of intangible rights (note 4)	(335)	-	(335)	(122)
	(348)	(5)	451	485
Financing activities				
Proceeds from exercise of stock options (note 5)	15	-	15	-
Increase (Decrease) in cash	1,188	531	1,304	(247)
Cash and cash equivalents, beginning of period	9,122	9,103	9,006	9,881
Cash and cash equivalents, end of period	**$** 10,310	**$** 9,634	**$** 10,310	**$** 9,634

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

Cipher Pharmaceuticals Inc.

Notes to Unaudited Financial Statements
June 30, 2010
(in thousands of dollars, except per share amounts)

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited interim financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada for interim reporting. Accordingly, these financial statements do not include all of the disclosures required by generally accepted accounting principles for annual financial statements and should be read in conjunction with the annual financial statements of the Company. In the opinion of management, all adjustments considered necessary for fair presentation have been included. All such adjustments are of a normal recurring nature. Operating results for the six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2010.

There have been no changes to the accounting policies as described in Note 1 to the financial statements for the year ended December 31, 2009.

2 FOREIGN EXCHANGE FORWARD CONTRACT

During the second quarter of 2010, the Company entered into a foreign exchange forward contract related to the net sales milestone of US$1 million under the Lipofen licensing and distribution agreement which was achieved at the end of the quarter. The contract matures on July 30, 2010 at an exchange rate of $1.031 against the US dollar. This foreign exchange forward contract is considered as an effective hedge to the US$1 million milestone and as such has been included in Accounts Receivable at the hedge rate.

3 LOAN RECEIVABLE

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

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 Company may be required to pay additional amounts to Galephar in respect of the CIP-ISOTRETINOIN and CIP-TRAMADOL ER intangible rights of up to $1,145 (US$1,080) if certain future milestones are achieved as defined in the agreements. These additional payments will be made in the form of additional Galephar preferred share purchases. The recovery of these intangible rights is dependant upon sufficient revenues being generated from the related products currently under development and commercialization. The Company is currently amortizing the intangible rights related to CIP-FENOFIBRATE and CIP-ISOTRETINOIN.

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

CIP-ISOTRETINOIN - in August 2008, the Company entered into a development, distribution and supply agreement with Ranbaxy Pharmaceuticals Inc. ("Ranbaxy") under which Ranbaxy was granted the exclusive right to market, sell and distribute the product in the United States. To date, the Company has received an up-front licensing payment of US$1 million and a milestone payment of US$2 million as a result of reaching 50% of the patient enrolment level for the clinical trial. Under the terms of the the agreement the Company could receive additional pre- and post-commercialization milestone payments of up to US$21 million, based on the achievement of certain milestone targets. Once the product is commercialized, the Company will also receive a royalty based on a percentage of net sales. In addition, Ranbaxy will reimburse the Company for the costs associated with the clinical studies required by the FDA to secure NDA approval, up to a predetermined cap. Any additional development costs associated with initial FDA approval will be shared equally. The Company is responsible for all product development activities, including management of the clinical studies required by the FDA to secure NDA approval and is also responsible for product supply and manufacturing, which will be fulfilled by Galephar. 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 royalties received by the Company under the agreement will be paid to Galephar.

CIP-TRAMADOL ER - In May 2010, the Company received final approval from the FDA for its extended-release tramadol product for the treatment of moderate to moderately severe chronic pain in adults. The achievement of FDA approval triggers additional milestone payments to Galephar as the Company prepares for commercial manufacturing. During the second quarter of 2010 a payment of $335 was made to acquire additional intangible rights for CIP-TRAMADOL ER.

5 SHARE CAPITAL

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

Issued share capital
The following is a summary of the changes in share capital from December 31, 2008 to June 30, 2010:

	Number of common shares (in thousands)	Amount $
Balance outstanding - December 31, 2008 and December 31, 2009	24,055	49,948
Options exercised during Q2 2010	25	29
Balance outstanding - June 30, 2010	24,080	49,977

Stock option plan
The following is a summary of the changes in the stock options outstanding from December 31, 2008 to June 30, 2010:

	Number of options (in thousands)	Weighted average exercise price $
Balance outstanding - December 31, 2008	1,376	2.51
Granted in 2009	224	0.60
Expired in 2009	(20)	4.33
Balance outstanding - December 31, 2009	1,580	2.22
Granted during the three months ended March 31, 2010 (a)	222	1.60
Exercised during the three months ended June 30, 2010 (b)	(25)	0.61
Balance outstanding - June 30, 2010	1,777	2.17

At June 30, 2010, 1,054,560 options were fully vested and exercisable (766,974 at June 30, 2009).

(a) During the three months ended March 31, 2010, the Company issued 221,500 stock options under the employee and director stock option plan, which have an exercise price of $1.60, 25% of which vest on February 19 of each year, commencing in 2011, and expire in 2020. Total compensation cost for these stock options is estimated to be $317. This cost will be recognized over the vesting period of the stock options.

The stock options issued during the three months ended March 31, 2010 were valued using the Black-Scholes option pricing model with the following assumptions:

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

(b) During the three months ended June 30, 2010, 25,000 stock options were exercised for a total cash consideration of $15. Capital stock increased by $29 representing the cash consideration of $15 and a $14 reduction in contibuted surplus. No stock options were exercised in the three months ended June 30, 2009.

6 EARNINGS PER SHARE

Earnings per share is calculated using the weighted average number of shares outstanding. The weighted average number of shares outstanding for the three and six month periods ended June 30, 2010 was 24,071,087 and 24,063,027 respectively (for both the three and six month periods ended June 30, 2009 the amount was 24,054,878). The dilutive impact on earnings per share for the three and six month periods ended June 30, 2010 is not significant.

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

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

John MacInnis
Vice President,
Portfolio Development and Licensing

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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