

LORUS THERAPEUTICS INC.

Q2 Financial Report

Three and six months ended November 30, 2006 and 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following information prepared as at **January 8, 2007** should be read in conjunction with the unaudited consolidated financial statements and notes prepared in accordance with Canadian generally accepted accounting principles (GAAP) in this quarterly report and should also be read in conjunction with the audited consolidated financial statements and notes and management's discussion and analysis contained in the Company's annual report for the year ended May 31, 2006. All amounts are expressed in Canadian dollars unless otherwise noted.

Overview of the Business

Lorus is a Canadian biotechnology company, traded on both the TSX (LOR) and AMEX (LRP), focused on the discovery, research and development of well-tolerated therapies that manage cancer and promote an improved quality of life. We are currently operating several research and pre-clinical programs in-house and have two products in clinical development with a Phase II clinical trial program underway. We continue to focus on partnership activities for all of our drug candidates.

The lead drugs in our antisense portfolio, GTI-2040 and GTI-2501, continue to advance in the clinic. There are currently six clinical trials with GTI-2040 sponsored by the US National Cancer Institute (NCI) in six different indications underway, as well as a Phase I/II clinical trial with GTI-2501 for the treatment of prostate cancer. We announced during the first quarter that an additional trial, to be sponsored by the US NCI, using GTI-2040 for the treatment of myelodysplastic syndrome would be initiated during the third quarter.

We have continued the development of our small molecule program by advancing our lead molecule, LT-253 into toxicity studies. We anticipate that upon successful results of these toxicity studies that we will be in the position to initiate a Phase I clinical trial.

In addition, Lorus has other novel, proprietary drug candidates in its product development pipeline including tumor suppressor/gene therapy approach and other low molecular weight compounds.

Results of Operations

Cash used in Operating Activities

Cash used in operating activities was \$2.6 million for the three-month period ended November 30, 2006 compared to \$2.4 million in the same period last year. For the six-month period ended November 30, 2006 cash used in operating activities totaled \$4.4 million compared with \$7.2 million for the six months ended November 30, 2005. The increase in cash used during the three-month period ended November 30, 2006 is due to cash utilized to reduce the accounts payable and accrued liabilities balances offset by lower research and development expenditures compared with an increase in accounts payable and accrued liabilities for the quarter ended November 30, 2005. The decrease in cash used in operating activities for the six-month period ended November 30, 2006 is the result of reduced research and development and general and administrative expenditures in the current year offset by cash used to reduce accounts payable and accrued liabilities compared with an increase in accounts payable and accrued liabilities balances in the prior year.

Research and Development

Research and development expenses for the three-month period ended November 30, 2006 decreased 57.4% to \$1.1 million compared to \$2.6 million for the same period last year. For the six-month period ended November 30, 2006, research and development expenses decreased 62.8% to \$2.5 million compared to \$6.6 million for the same period last year. The decrease in research and development costs is primarily due to a reduction in toxicity study, clinical trial, compliance, manufacturing and regulatory costs associated with the Phase III Virulizin[®] development program which was ongoing during the six-month period ended November 30, 2005, which was subsequently completed. In addition, due to headcount reductions implemented in the three months ended November 30, 2005, we have fewer employees engaged in research and development activities. The ongoing research and development costs relate to the GTI-2040 and GTI-2501 clinical development programs ongoing as well as our small molecule pre-clinical program.

General and Administrative

General and administrative expenses for the three-month period ended November 30, 2006 decreased to \$1.4 million compared with \$1.6 million in the same period last year. General and administrative expenses for the six-month period ended November 30, 2006 decreased to \$2.2 million compared with \$2.7 million in the same period last year. The decrease in general and administrative costs is the result of lower levels of staff following the November 2005 headcount reductions and the severance costs associated with those reductions as well as lower corporate communication costs totaling \$1.0 million offset by charges incurred under the mutual separation agreement entered into with Dr. Jim Wright, of \$500 thousand discussed under "Corporate Changes" below.

Stock-Based Compensation

Stock-based compensation expense decreased to \$150 thousand for the three-month period ended November 30, 2006 compared with \$414 thousand for the same period last year and \$263 thousand for the six-month period ended November 30, 2006 compared with \$705 thousand for the six-month period ended November 30, 2005.

The decrease in stock-based compensation expense is attributable to fewer options issued due to fewer employees and executive officers, a lower fair value assigned to the options issued resulting from a lower stock price, as well as the reversal of stock option expense previously recorded of \$330 thousand for the six months ended November 30, 2006 due to the forfeiture of unvested options upon non-achievement of certain objectives.

Interest and Accretion Expense

We recognized non-cash interest expense of \$262 thousand for the three-month period ended November 30, 2006 compared with \$209 thousand in the same period last year and \$527 thousand for the six-month period ended November 30, 2006 compared with \$407 thousand in the same period last year representing interest at a rate of prime +1% on our \$15.0 million convertible debentures (the 'debentures'). The increase in interest expense over the prior periods is the result of increases in the prime rate of interest in comparison with the prior periods. The interest accrued on the debenture during the three and six-month periods ended November 30, 2006 was paid in common shares of the Company, a non-cash expense.

Accretion in the carrying value of the convertible debenture amounted to \$227 thousand for the three-month period ended November 30, 2006 compared with \$180 thousand in the same period last year and \$446 thousand for the six-month period ended November 30, 2006 compared with \$366 thousand for the six months ended November 30, 2005. The accretion charges arise as under Canadian GAAP, the Company has allocated the proceeds from each tranche of the convertible debenture to the debt and equity instruments issued on a relative fair value basis resulting in the \$15.0 million convertible debentures having an initial cumulative carrying value of \$9.8 million as of their dates of issuance. The carrying value of the convertible debt is accreted to its maturity amount.

Depreciation and Amortization

Depreciation and amortization expense for the three-month and six-month periods ended November 30, 2006 was \$100 thousand and \$200 thousand, respectively, compared to \$130 thousand and \$260 thousand for the same periods in the prior year. The decrease in depreciation and amortization expense is the result of reduced capital asset purchases during fiscal 2006 and 2007.

Amortization of Deferred Financing Charges

Amortization of deferred financing charges for the three-month and six-month periods ended November 30, 2006 were \$27 thousand and \$52 thousand, respectively, compared to \$19 thousand and \$39 thousand for the same periods in the prior year.

Interest Income

Interest income for the three-month period ended November 30, 2006 was \$158 thousand, compared with \$95 thousand for the same period last year. The increase in the current year is attributable to a slightly higher average cash and short-term investment balance during the period as well as higher interest rates. For the six-month period ended November 30, 2006, interest income was \$225 thousand

compared to \$210 thousand for the same period last year. The small increase is attributable to higher interest rates offset by a lower average cash and short-term investment balance during the first half of fiscal 2007 as the financing proceeds discussed below were not received until the end of the first quarter.

Net Loss

Net loss for the three-month period ended November 30, 2006 totaled \$3.1 million (\$0.01 per share) compared to a loss of \$5.1 million (\$0.03 per share) for the same period last year. For the six-month period ended November 30, 2006, net loss totaled \$5.9 million (\$0.03 per share) compared to \$10.8 million (\$0.06 per share) for the comparable period last year. The decrease in net loss for the three-month period ended November 30, 2006 is primarily the result of reductions in research and development expenses of \$1.5 million, general and administrative expenses of \$212 thousand and stock based compensation expense of \$264 thousand. The year-to-date decrease in net loss is due primarily to a reduction of \$4.1 million in research and development expenses, lower general and administrative expense of \$500 thousand and lower stock-based compensation expense of \$442 thousand.

Financing

On August 30, 2006, Lorus raised gross proceeds of \$10.4 million by way of a subscription agreement for 28.8 million common shares at a price of \$0.36 per common share. The 28.8 million common shares have been qualified for distribution in Canada under a short form prospectus filed on August 25, 2006 with the Ontario Securities Commission. In addition to the qualification prospectus filed in August, the investor received demand registration rights that will enable the investor to request Lorus to file a Canadian prospectus or a registration statement under the United States Securities Act (Registration Documents) to register the resale of all or part of the common shares held by the Investor, subject to certain restrictions. Lorus is required to file a maximum of five Registration Documents at the investor's request. These demand registration rights will expire on June 30, 2012.

On August 31, 2006, Lorus raised gross proceeds of \$1.8 million by way of a private placement for 5.0 million common shares at a price of \$0.36 per common share.

We incurred expenses of \$527 thousand related to these issuances, which have been recorded as a reduction to share capital.

During the quarter ended August 31, 2006, 46,000 stock options were exercised for cash proceeds of \$14 thousand (August 31, 2005 – nil). There were no stock options exercised during the three-month period ended November 30, 2006 or 2005.

Corporate Changes

On September 19, 2006 the Company announced that Dr. Jim Wright would step down as the President and Chief Executive Officer effective September 21, 2006. The departure of Dr. Jim Wright resulted in a liability based on a mutual separation agreement executed between Dr. Jim Wright and Lorus. As a result we have recorded severance compensation expense of \$500 thousand recorded in general and administrative expense. Accrued liabilities at November 30, 2006 include severance and compensation expense liabilities of \$250 thousand that will be paid out by January 2007.

Quarterly Financial Information (unaudited)

(in thousands of dollars, except per share amounts)

The selected financial information provided below is derived from the Company's unaudited quarterly financial statements for each of the last eight quarters, all of which cover periods of three months.

(Amounts in 000's except for per common share data)	Nov. 30, 2006	Aug. 31, 2006	May 31, 2006	Feb. 28, 2006	Nov. 30, 2005	Aug. 31, 2005	May 31, 2005	Feb. 28, 2005
Revenue	\$ 23	\$ 7	\$ 14	\$ 5	\$ 6	\$ 1	\$ -	\$ 3
Research and development	1,122	1,331	1,353	2,296	2,631	3,957	2,332	3,175
General and administrative	1,407	788	730	909	1,619	1,076	1,506	1,484
Net loss	(3,117)	(2,770)	(2,920)	(4,095)	(5,102)	(5,742)	(4,598)	(5,274)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.03)
Cash used in operating activities	(2,585)	\$(1,814)	\$(1,940)	\$(3,956)	\$(2,360)	\$(4,809)	\$(3,789)	\$(4,106)

Liquidity and Capital Resources

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity and debt financing, the exercise of warrants and stock options, and interest income on funds held for future investment. We expect to continue to finance the GTI-2501 Phase I/II clinical trial and the development of our small molecule program from internal resources until their anticipated completion. The ongoing costs of the GTI-2040 Phase II clinical program will continue to be borne by the US NCI with Lorus continuing to be responsible for any additional GTI-2040 manufacturing costs. We currently have a sufficient supply of GTI-2040 on hand to complete the clinical trials underway.

We have not earned substantial revenues from our drug candidates and are therefore considered to be in the development stage. The continuation of our research and development activities and the commercialization of the targeted therapeutic products are dependent upon our ability to successfully finance and complete our research and development programs through a combination of equity financing and payments from strategic partners. We have no current sources of payments from strategic partners. In addition, we will need to repay or refinance the secured convertible debentures on their maturity should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further development of our products or to repay the convertible debentures on maturity. If we are not able to raise additional funds, we may not be able to continue as a going concern and realize our assets and pay our liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for our financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

Our current level of cash and short-term investments are sufficient to execute our current planned expenditures for the next twelve months.

Cash Position

At November 30, 2006 Lorus had cash and cash equivalents and short-term investments totaling \$9.9 million compared to \$8.3 million at May 31, 2006. Working capital was \$8.0 million at November 30, 2006 compared to \$5.8 million at May 31, 2006.

Contractual Obligations and Off-Balance Sheet Financing

At November 30, 2006, we had contractual obligations requiring annual payments as follows:

(Amounts in 000's)

	Less than 1 year	1-3 years	4-5 years	5+ years	Total
Operating leases	139	56	—	—	195
Convertible Debenture ¹	—	—	15,000	—	15,000
<i>Total</i>	<i>139</i>	<i>56</i>	<i>15,000</i>	<i>—</i>	<i>15,195</i>

¹ The convertible debentures as described above may be converted into common shares of Lorus at a conversion price of \$1.00. In the event that the holder does not convert the debentures, Lorus has an obligation to repay the \$15.0 million in cash.

Outlook

Until one of our drug candidates receives regulatory approval and is successfully commercialized, Lorus will continue to incur operating losses. The magnitude of these operating losses will be largely affected by the timing and scope of future research and development, clinical trials and other development activities related to the Company's lead products, as well as any new initiatives. Finally, the duration of the operating losses will depend on the scientific results of such clinical trials.

Risks and Uncertainties

Please refer to the MD&A included in our 2006 Annual Report for a complete discussion of risks and uncertainties.

Some of the most immediate risks and uncertainties facing us in the next fiscal year include:

- We have a history of operating losses. We expect to incur additional losses and we may never achieve or maintain profitability.
- We will need to raise additional funds to conduct research and development, preclinical studies, and clinical trials necessary to bring our potential products to market. We intend to raise additional financing, as required, through strategic alliance arrangements, the exercise of options and warrants, and the issuance of new share capital, as well as through other financing opportunities. There can be no assurance that these financing efforts will be successful or that we will continue to be able to meet our ongoing cash requirements.
- We may be unable to obtain partnerships for one or more of our product candidates which could curtail future development and negatively impact our share price.
- We may never develop any commercial drugs or other products that generate revenues.
- We may be unable to obtain patents to protect our technologies from other companies with competitive products, and patents of other companies could prevent us from manufacturing, developing or marketing our products.
- We may violate one or more of the operational covenants related to our convertible debentures that could result in an event of default and the requirement for early payment of our convertible debentures.
- Our cash flow may not be sufficient to cover interest payments on the secured convertible debentures or to repay the debentures upon maturity or in the event of default.
- Our share price has been and may continue to be volatile and an investment in our common shares could suffer a decline in value.
- Future sales of our common shares by us or by our existing shareholders could cause our share price to fall.

Critical Accounting Policies and Estimates

Our accounting policies are in accordance with Canadian GAAP including some that require management to make assumptions and estimates that could significantly affect the results of operations and financial position. The significant accounting policies that we believe are the most critical in fully understanding and evaluating the reported financial results are disclosed in the MD&A section of our 2006 Annual

Report. As well, our significant accounting policies are disclosed in Note 2, *Significant Accounting Policies*, of the notes to our audited consolidated financial statements for the fiscal year ended May 31, 2006.

Disclosure Controls

Lorus announced during the three-months ended November 30, 2006 that Dr. Jim Wright would be resigning as the Company's President and CEO effective September 21, 2006. Lorus also announced that Dr. Aiping Young, the Company's COO, would be appointed President and CEO effective the same day as Dr. Jim Wright's resignation. As Lorus was not without a President and CEO for any period of time, and given Dr. Aiping Young's knowledge of the Company and its internal and disclosure controls, we do not believe that our current internal and disclosure control structure has been compromised from this change in management.

Updated Share Information

As at January 8, 2007, the number of issued and outstanding common shares of the Company was 210,734,904. In addition, there were 3,000,000 warrants to purchase 3,000,000 common shares of the Company and 14,065,000 stock options outstanding can be exercised into an equal number of common shares. The convertible debentures are convertible into 15,000,000 common shares of the Company at the option of the holder.

Forward Looking Statements

This management discussion and analysis may contain forward-looking statements within the meaning of Canadian and U.S. securities laws. Such statements include, but are not limited to, statements relating to: our expectations regarding future financings, our plans to conduct clinical trials, the successful and timely completion of clinical studies and the regulatory approval process, our plans to obtain partners to assist in the further development of our product candidates, the establishment of corporate alliances, the Company's plans, objectives, expectations and intentions and other statements including words such as "continue", "believe", "plan", "expect", "intend", "will", "should", "may", and other similar expressions. Such statements reflect our current views with respect to future events and are subject to risks and uncertainties and are necessarily based upon a number of estimates and assumptions that, while considered reasonable by us are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements, including, among others:

- our ability to obtain the capital required for research and operations
- the regulatory approval process;
- the progress of our clinical trials;
- our ability to find and enter into agreements with potential partners;
- our ability to attract and retain key personnel;
- changing market conditions; and
- other risks detailed from time-to-time in our ongoing quarterly filings, annual information forms, annual reports and annual filings with Canadian securities regulators and the United States Securities and Exchange Commission

Should one or more of these risks or uncertainties materialize, or should the assumptions set out in the section entitled "Risk Factors" in our Annual Report underlying those forward-looking statements prove incorrect, actual results may vary materially from those described herein. These forward-looking statements are made as of the date of this press release and we do not intend, and do not assume any obligation, to update these forward-looking statements, except as required by law. We cannot assure you that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements. Investors are cautioned that forward-looking statements are not guarantees of future performance and accordingly investors are cautioned not to put undue reliance on forward-looking statements due to the inherent uncertainty therein.

Lorus Therapeutics Inc.
Interim Consolidated Balance Sheets

<i>(amounts in 000's)</i> <i>(Canadian dollars)</i>	As at November 30, 2006 (Unaudited)	As at May 31, 2006 (Audited)
ASSETS		
Current		
Cash and cash equivalents	\$ 7,040	\$ 2,692
Marketable securities and other investments (note 4)	2,848	5,627
Prepaid expenses and other assets	785	515
	10,673	8,834
Long-term		
Marketable securities and other investments (note 4)	5,686	-
Fixed assets	685	885
Deferred financing charges	429	481
Goodwill	606	606
Acquired patents and licenses	-	655
	7,406	2,627
	\$ 18,079	\$ 11,461
LIABILITIES		
Current		
Accounts payable	\$ 584	\$ 555
Accrued liabilities (note 5)	2,046	2,460
	2,630	3,015
Long-term		
Secured convertible debentures (note 6)	11,448	11,002
SHAREHOLDERS' EQUITY		
Common shares (note 2)	157,190	145,001
Equity portion of secured convertible debentures	3,814	3,814
Stock options (note 3(c))	4,743	4,525
Contributed surplus (note 2(e))	7,702	7,665
Warrants (note 2)	991	991
Deficit accumulated during development stage	(170,439)	(164,552)
	4,001	(2,556)
	\$ 18,079	\$ 11,461

See accompanying notes to the unaudited consolidated interim financial statements

Basis of Presentation Note 1

Contingency Note 6

Lorus Therapeutics Inc.
Interim Consolidated Statements of Loss and Deficit (unaudited)

	Three		Six		Period
(amounts in 000's except for per common share data)	months ended	months ended	months ended	months ended	from inception
(Canadian dollars)	Nov 30, 2006	Nov 30, 2005	Nov 30, 2006	Nov 30, 2005	Sept. 5, 1986 to Nov 30, 2006
REVENUE	\$ 23	\$ 6	\$ 30	\$ 7	\$ 736
EXPENSES					
Cost of sales	3	1	6	1	93
Research and development (note 5)	1,122	2,631	2,453	6,588	112,928
General and administrative (note 5)	1,407	1,619	2,195	2,695	49,670
Stock-based compensation (note 3)	150	414	263	705	7,013
Depreciation and amortization of fixed assets	100	130	200	260	9,023
Operating expenses	2,782	4,795	5,117	10,249	178,727
Interest expense on convertible debentures	262	209	527	407	1,709
Accretion in carrying value of convertible debentures	227	180	446	366	1,662
Amortization of deferred financing charges	27	19	52	39	223
Interest income	(158)	(95)	(225)	(210)	(11,146)
Loss for the period	3,117	5,102	5,887	10,844	170,439
Deficit, beginning of period	167,322	152,385	164,552	146,643	-
Deficit, end of period	\$ 170,439	\$ 157,487	\$ 170,439	\$ 157,487	\$ 170,439
Basic and diluted loss per common share	\$ 0.01	\$ 0.03	\$ 0.03	\$ 0.06	
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share	209,992	173,110	198,261	172,911	

See accompanying notes to the unaudited interim consolidated financial statements

Lorus Therapeutics Inc.
Interim Consolidated Statements of Cash Flows (unaudited)

<i>(amounts in 000's)</i> <i>(Canadian Dollars)</i>	Three months ended Nov 30, 2006	Three months ended Nov 30, 2005	Six months ended Nov 30, 2006	Six months ended Nov 30, 2005	from inception Sept. 5, 1986 to Nov 30, 2006
OPERATING ACTIVITIES					
Loss for the period	\$ (3,117)	\$ (5,102)	\$ (5,887)	\$ (10,844)	\$ (170,439)
Add items not requiring a current outlay of cash:					
Stock-based compensation	150	414	263	705	7,013
Interest expense on convertible debentures	262	209	527	407	1,709
Accretion in carrying value of convertible debentures	227	180	446	366	1,662
Amortization of deferred financing charges	27	19	52	39	223
Depreciation, amortization and write-down of fixed assets and acquired patents and licenses	362	522	855	1,045	21,584
Other	-	-	-	-	707
Net change in non-cash working capital balances related to operations	(496)	1,398	(655)	1,113	937
Cash used in operating activities	(2,585)	(2,360)	(4,399)	(7,169)	(136,604)
INVESTING ACTIVITIES					
Maturity (purchase) of marketable securities and other investments, net	(3,661)	6,759	(2,907)	14,988	(8,534)
Business acquisition, net of cash received	-	-	-	-	(539)
Acquired patents and licenses	-	-	-	-	(715)
Additions to fixed assets	-	(3)	-	(73)	(6,049)
Cash proceeds on sale of fixed assets	-	-	-	-	348
Cash (used in) provided by investing activities	(3,661)	6,756	(2,907)	14,915	(15,489)
FINANCING ACTIVITIES					
Issuance of debentures, of issuance costs	-	-	-	-	12,948
Issuance of warrants	-	-	-	-	37,405
Issuance of common shares, net	-	-	11,654	-	109,025
Additions to deferred financing charges	-	-	-	-	(245)
Cash provided by financing activities	-	-	11,654	-	159,133
(Decrease) increase in cash and cash equivalents during the period	(6,246)	4,396	4,348	7,746	7,040
Cash and cash equivalents, beginning of period	13,286	6,126	2,692	2,776	-
Cash and cash equivalents, end of period	\$ 7,040	\$ 10,522	\$ 7,040	\$ 10,522	\$ 7,040

See accompanying notes to the unaudited consolidated interim financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three and six months ended November 30, 2006 and 2005

1. Basis of presentation

These unaudited interim consolidated financial statements of Lorus Therapeutics Inc. ("the Company") have been prepared by the Company in accordance with Canadian generally accepted accounting principles for interim financial statements and do not include all the information required for complete financial statements. The unaudited interim financial statements follow the same accounting policies and methods of application as the audited annual financial statements for the year ended May 31, 2006. These statements should be read in conjunction with the audited consolidated financial statements for the year ended May 31, 2006.

The information presented as at and for the three and six months ended November 30, 2006 and November 30, 2005 reflect, in the opinion of management, all adjustments consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

The Company has not earned substantial revenues from its drug candidates and is therefore considered to be in the development stage. The continuation of the Company's research and development activities is dependent upon the Company's ability to successfully finance its cash requirements through a combination of equity financing and payments from strategic partners. The Company has no current sources of payments from strategic partners. In addition, the Company will need to repay or refinance the secured convertible debentures on their maturity should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further development of the Company's product candidates or to repay the convertible debentures on maturity.

Management believes that the Company's current level of cash and short-term investments will be sufficient to execute the Company's current planned expenditures for the next twelve months. If the Company is not able to raise additional funds, it may not be able to continue as a going concern and realize its assets and pay its liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

2. Share capital

(a) Continuity of common shares and warrants

(amounts and units in 000's)	Common Shares		Warrants	
	Number	Amount	Number	Amount
Balance at May 31, 2005	172,541	\$144,119	3,000	\$ 991
Interest payments (b)	265	198	—	—
Balance at August 31, 2005	172,806	\$144,317	3,000	\$ 991
Interest payments (b)	537	209	—	—
Balance at November 30, 2005	173,343	\$144,526	3,000	\$ 991
Interest payments (b)	672	224	—	—
Balance at February 28, 2006	174,015	\$144,750	3,000	\$ 991
Interest payments (b)	679	251	—	—
Balance at May 31, 2006	174,694	\$145,001	3,000	\$ 991
Equity issuance (c)	33,800	11,640	—	—
Interest payments (b)	792	265	—	—
Stock option exercises	46	22	—	—
Balance at August 31, 2006	209,332	\$156,928	3,000	\$ 991
Interest payments (b)	1,031	262	—	—
Balance at November 30, 2006	210,363	\$157,190	3,000	\$ 991

(b) Interest payments

Interest payments relate to interest payable on the \$15.0 million convertible debentures payable at a rate of prime +1% until such time as the Company's share price reaches \$1.75 for 60 consecutive trading days, at which time, interest will no longer be charged. Common shares issued in payment of interest were issued at a price

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three and six months ended November 30, 2006 and 2005

equal to the weighted average trading price of such shares for the ten trading days immediately preceding their issue in respect of each interest payment.

(c) Equity issuances

On August 30, 2006, the Company raised gross proceeds of \$10.4 million by way of a subscription agreement for 28.8 million common shares at a price of \$0.36 per common share. The 28.8 million common shares have been qualified for distribution in Canada under a short form prospectus filed on August 25, 2006 with the Ontario Securities Commission. In connection with the transaction, the investor received demand registration rights that will enable the investor to request the registration or qualification of the common shares for resale in the United States and Canada, subject to certain restrictions. These demand registration rights will expire on June 30, 2012.

On August 31, 2006, the Company raised gross proceeds of \$1.8 million by way of a private placement for 5.0 million common shares at a price of \$0.36 per common share.

The Company incurred expenses of \$527 thousand related to these issuances, which have been recorded as a reduction to share capital.

During the quarter ended August 31, 2006, 46 thousand stock options were exercised for cash proceeds of \$14 thousand (August 31, 2005 – nil)

(d) Loss per share

The Company has excluded from the calculation of diluted loss per share all common shares potentially issuable upon the exercise of stock options, warrants and the convertible debenture that could dilute basic loss per share, because to do so would be anti-dilutive.

(e) Continuity of contributed surplus

<i>(amounts in 000's)</i>	Year to date 2007	Year to date 2006
Balance at beginning of the year	\$ 7,665	\$ 6,733
Forfeiture of vested options	37	16
Balance at end of the period	\$ 7,702	\$ 6,749

3. Stock-based compensation

(a) Continuity of stock options

	Six months ended Nov 30, 2006 (000's)	Weighted average exercise price six months ended Nov 30, 2006	Six months ended Nov 30, 2005 (000's)	Weighted average exercise price six months ended Nov 30, 2005
Outstanding at beginning of period	10,300	\$ 0.70	8,035	\$ 0.96
Granted	5,318	\$ 0.30	4,044	\$ 0.77
Exercised	(46)	\$ 0.30	—	—
Forfeited	(1,506)	\$ 0.48	(372)	\$ 0.84
Outstanding at end of period	14,066	\$ 0.55	11,707	\$ 0.86

For the three and six month periods ended November 30, 2006 stock compensation expense of \$150 thousand (2006 - \$414 thousand) and \$263 thousand (2006 - \$705 thousand) respectively, was recognized, representing the amortization applicable to the current period of the estimated fair value of options granted since June 1, 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three and six months ended November 30, 2006 and 2005

(b) Fair value assumptions

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of stock options granted during the period:

	Three months ended Nov 30, 2006	Six months ended Nov 30, 2006	Three months ended Nov 30, 2005	Six months ended Nov 30, 2005
Risk free interest rate	4.50%	4.50%	3.00%	2.25 – 3.00%
Expected dividend yield	0%	0%	0%	0%
Expected volatility	75%	75-80%	70-80%	70-80%
Expected life of options	5 years	5 years	1-5 years	1-5 years
Weighted average fair value of options granted or modified in the period	\$0.18	\$0.20	\$0.22	\$0.40

The amounts estimated according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

(c) Continuity of stock options

(amounts in 000's)	2007	2006
Balance at beginning of the year	\$ 4,525	\$ 4,252
Forfeiture of vested stock options	(16)	—
Stock option exercise	(8)	—
Stock option expense	113	291
Balance at August 31,	\$ 4,614	\$ 4,543
Stock option expense	150	414
Forfeiture of vested stock options	(21)	(16)
Balance at November 30,	\$ 4,743	\$ 4,941

4. Marketable securities and other investments

As at November 30, 2006 (amounts in 000's)

	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Fixed income government investments	\$ 2,848	\$ 1,559	\$ 4,407	3.64-3.91%
Corporate instruments	—	4,127	4,127	4.01-4.12%
Balance	\$ 2,848	\$ 5,686	\$ 8,534	

As at May 31, 2006 (amounts in 000's)

	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Fixed income government investments	\$ 2,838	\$ —	\$ 2,838	3.55-3.64%
Corporate instruments	2,789	—	2,789	3.46-3.87%
Balance	\$ 5,627	\$ —	\$ 5,627	

At November 30, 2006 and May 31, 2006, the carrying values of short-term investments approximate their quoted market values. Short-term investments held at November, 2006 have varying maturities from one to ten months (May 2006 – one to six months).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three and six months ended November 30, 2006 and 2005

5. Corporate changes

- (a) In November 2005, as a means to conserve cash and refocus operations, the Company scaled back some activities related to the Virulizin[®] technology and implemented a workforce reduction of approximately 39% or 22 employees.

In accordance with EIC 134 – *Accounting for Severance and Termination Benefits*, during the three-month and six-month periods ended November 30, 2005 the Company recorded severance compensation expense for former employees of \$557 thousand. Of this expense, \$468 thousand was presented in the income statement as general and administrative expense and \$89 thousand as research and development expense. All severance and compensation expense liabilities relating to the Company's November 2005 corporate changes have been paid as of November 30, 2006 (May 31, 2006 - \$154 thousand remained in accrued liabilities).

- (b) On September 19, 2006 the Company announced that Dr. Jim Wright would step down as the President and Chief Executive Officer effective September 21, 2006. The departure of Dr. Wright resulted in a liability based on a mutual separation agreement executed during the three months ended May 31, 2006 of \$500 thousand recorded in general and administrative expense. Accrued liabilities at November 30, 2006 include severance liabilities relating to the mutual separation of \$250 thousand that will be paid during the third quarter.

6. Secured convertible debentures

The terms of the secured convertible debentures are described in note 13 to the Company's annual consolidated financial for the year ended May 31, 2006. The debentures are due on October 6, 2009 and may be converted at the holder's option at any time into common shares of the Company at a conversion price of \$1.00 per share. The lender has the option to demand repayment in the event of default, including the failure to maintain certain subjective covenants, representations and warranties.

Management assesses on a quarterly basis whether or not events during the quarter could be considered an event of default. This assessment was performed and management believes that there has not been an event of default and that, at November 30, 2006; the term of the debt remains unchanged.