



FIRST QUARTER REPORT
JULY 31, 2001



MICROLOGIX

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MICROLOGIX

MICROLOGIX develops novel drugs targeted at severe and life-threatening diseases—particularly those caused by antibiotic-resistant bacteria. Our drug candidates represent an entirely new class of antibiotics based on naturally occurring cationic peptides—small molecules integral to the host defense systems of most life forms. Micrologix currently has two drugs in clinical trials in the United States: MBI 226 for preventing central venous catheter-related bloodstream infections in Phase III and MBI 594AN for treating acne in Phase II. The Company's common shares are included in the TSE 300 Composite Index.

Forward-looking Statements

This Quarterly Report, including the discussion "To Our Shareholders" and "Management's Discussion & Analysis of Financial Condition and Results of Operations" contains forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements frequently, but not always, use the words "expects", "anticipates", "suggests", "plans", "believes" or "intends", or similar words and/or include statements concerning the Company's strategies, goals and plans, or state that certain actions, events or results "will" be taken, occur or be achieved. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievement of the company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such statements. Such factors include, among others those described in the Company's Annual Information Form, including among others, the following: uncertainties related to early stage of development, technology and product development; dependence on future corporate collaborations; dependence on proprietary technology and uncertainty of patent protection; management of growth; future capital needs and uncertainty of additional funding; intense competition; manufacturing and market uncertainties; government regulation; product liability exposure and insurability.

TO OUR SHAREHOLDERS:

This quarter was highlighted by completing the enrollment for our US Phase II clinical trial of MBI 594AN for the treatment of acne and the recruitment of a new President & CEO. Additionally, enrollment of patients in a US FDA fast-tracked Phase III clinical trial of MBI 226 for the prevention of catheter-related bloodstream infections continued. We also released exciting new preclinical data showing significant anti-inflammatory activity of our peptides, which further supports the therapeutic potential for MBI 594AN in the treatment of acne. Lastly, we made the difficult decision to suspend further clinical testing of MBI 853NL in preventing hospital-acquired infections caused by *Staphylococcus aureus* (*S. aureus*).

PHASE III TRIAL MBI 226

In September 2000, Micrologix commenced a pivotal Phase III trial of MBI 226 for the prevention of catheter-related bloodstream infections. The fast-track Phase III clinical trial of MBI 226 is proceeding, with approximately 500 subjects enrolled at 16 sites dispersed geographically across the US. It is expected that enrollment should approach 1,000 by the end of 2001 and the target of 1500 patients will be reached by June 2002. Clinical results for MBI 226 are expected to be available in the second half of 2002, approximately six months later than originally anticipated.

The objective of the trial is to demonstrate that MBI 226, administered at central venous catheter insertion sites, reduces or eliminates bacterial and fungal colonization of central venous catheters and prevents subsequent bloodstream infections. Results of the study will be used in support of a New Drug Application to market MBI 226 in the US.

MBI 594AN PHASE II TRIAL ENROLLMENT COMPLETED

In November of 2000, we initiated a US Phase II clinical trial of MBI 594AN for the treatment of acne. The trial is a randomized, double-blind, placebo-controlled, dose-ranging efficacy study. Patients were treated with either a placebo or one of two dose levels of MBI 594AN (daily treatments over a period of six weeks). The activity of MBI 594AN will be assessed based on acne lesion counts and physician assessment of each patient during the study.

We successfully completed enrollment of 75 subjects for the trial at the end of July and treatment of the final subjects was completed in early September. We look forward to receiving the results of this study in November.

ANTI-INFLAMMATORY PROPERTIES OF MBI PEPTIDES PROMISING FOR ACNE PROGRAM AND OTHER DERMATOLOGY APPLICATIONS

During the quarter, we presented new preclinical data demonstrating our peptides have significant anti-inflammatory properties. In an *in vivo* animal model our peptides showed a marked ability to reduce inflammation, similar to that of hydrocortisone, which is known to be a potent anti-inflammatory agent. These data further support our belief that MBI 594AN, currently in a Phase II clinical trial, will be effective in treating acne. In addition, these data suggest that MBI's peptides hold promise for treating other skin diseases, such as psoriasis, eczema and dermatitis.

MBI 853NL PHASE I B RESULTS

In November of 2000, we initiated a US Phase Ib clinical trial of MBI 853NL in preventing hospital-acquired infections caused by *S. aureus*. The trial was a randomized, double-blind, placebo-controlled study to assess the safety and

tolerability of MBI 853NL applied intranasally to healthy volunteers who were persistent carriers of nasal *S. aureus*.

Data from the study found that MBI 853NL was safe, well tolerated and resulted in a decreased number of *S. aureus* organisms in all MBI 853NL-treated groups. Based on the level of reduction seen, however, and our experience in screening subjects for this trial, we believe that the future clinical development program for MBI 853NL would involve greater risk, time and costs than we can justify. Accordingly, we made a decision not to proceed to a Phase II efficacy study and are focussing our efforts on our later stage products and on building our product pipeline through expanded R&D efforts.

RECRUITMENT OF A NEW PRESIDENT & CEO

Since January I have carried out the responsibilities of President & CEO on an interim basis while a search to recruit a new President & CEO was in progress. The search culminated in the recruitment of Jim DeMesa, MD, as our new President & CEO, effective October 1, 2001. Dr. DeMesa brings to Micrologix a wealth of biotech and management experience and a proven record of growth and accomplishment. He was most recently President and Chief Executive Officer of GenSci Regeneration Sciences, a TSE-listed North American orthobiologics company. Dr. DeMesa led the company during its expansion from a small R&D firm to a fully integrated biotech company, growing revenues from zero to more than \$45 million within 3 years. He also helped to raise more than \$30 million in financing, establish strategic alliances with major corporate partners and grow the product line significantly.

We are confident that Jim has the leadership qualities, experience and vision to successfully guide Micrologix through the next stage in its development. Formally trained in both business and medicine, his knowledge and proven ability to lead, manage and grow companies will be of great benefit to us.

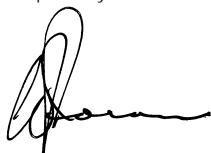
DAVID SCOTT APPOINTED CHAIRMAN OF THE BOARD

At this year's Annual General Meeting (AGM), I announced that I was retiring as Chairman of the Board and would be succeeded by my fellow Board member David Scott.

Mr. Scott has been an active director since his election to the Board at Micrologix's AGM last year. He has chaired the company's Compensation and Corporate Governance Committees and also chaired the Search Committee that recruited Dr. DeMesa. Mr. Scott has more than 30 years experience in investment analysis and management.

I have enjoyed serving Micrologix as Chairman and also interim President and CEO and I look forward to working closely with David and Jim during the coming months to ensure a successful transition.

Respectfully,



WILLIAM J. (BUD) FORAN
President and CEO, Director

September 17, 2001

Three months ended July 31, 2001

The following should be read in conjunction with the interim consolidated financial statements for the quarter ended July 31, 2001 and related notes therein, the audited consolidated financial statements for the year ended April 30, 2001 and related notes therein, and management's discussion & analysis of financial condition and results of operations for the year ended April 30, 2001.

RESULTS OF OPERATIONS

For the quarter ended April 30, 2001 ("Q1/02"), Micrologix incurred a net loss of \$4,613,340 (\$0.12 per share). This compares to a loss of \$1,752,766 (\$0.05 per share) for the same period in 2000 ("Q1/01"). The increase in loss results principally from the costs associated with our clinical development programs including the Phase III clinical trial of MBI 226 initiated in September 2000 (see "Research & Development Expenses"). By comparison the loss for the immediately preceding quarter (three months ended April 30, 2001) was \$4,257,187 (\$0.11 per share).

Revenues

Interest income for Q1/02 was \$666,135 compared to \$790,412 in Q1/01. This decrease resulted from declining interest rates and lower average cash balances available for investment.

Research and Development Expenses

Research and development expenses increased in Q1/02 to \$4,371,383 compared to \$1,876,974 in Q1/01. Clinical development program costs represented \$3,336,909 (Q1/01: \$1,024,883) of research and development expenses and are expected to continue to increase as we continue patient enrollment in the Phase III clinical trial for MBI 226 and pursue the further clinical development of MBI 594AN.

General and Corporate Expenses

General and corporate expenses for Q1/02 were \$908,092 compared to \$666,204 in Q1/01. This increase is spread across many expense categories and can be generally attributed to a greater level of activity associated with the advancement of our research & development programs.

CAPITAL EXPENDITURES

Expenditures in Q1/02 for capital assets were \$121,265 principally for upgrading of computer systems. During the quarter we wrote down computer equipment removed from active service, resulting in a \$20,295 charge to operations.

Expenditures in Q1/02 for intangible assets were \$74,804 principally for patent costs. Additionally, technology license costs capitalized in Q1/02 included "Shares to be issued" with a fair value of \$84,500. These shares were issued subsequent to the end of the quarter (see note 5 to the interim financial statements). During Q1/02, we wrote off a patent application no longer being pursued, resulting in a \$39,903 charge to operations.

Amortization expense increased to \$162,846 (Q1/01: \$117,950) in Q1/02 principally as a result of increases in Capital Assets and Intangible Assets.

**MANAGEMENT'S DISCUSSION & ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS, CONTINUED**

Three months ended July 31, 2001

LIQUIDITY AND CAPITAL RESOURCES

At July 31, 2001, we had \$52,707,807 (April 30, 2001: \$55,791,768) in cash, cash equivalents and short-term investments. This decrease is directly attributable to the loss for Q1/02.

OUTLOOK

Losses are expected to continue for the next several years as we pursue the research, development and commercialization of our drug candidates and technologies.

We believe that our current funds on hand, together with expected interest income, should be sufficient to finance our operations and capital needs for approximately the next two years. In the future, we will need to raise additional funds in support of our operations. Our funding needs will vary, however, depending upon a number of factors including the progress of research and development programs, the costs associated with clinical studies and the regulatory process, collaborative and licensing arrangements with third parties, opportunities to in-license complementary technologies, the possibility of unanticipated costs and expenses, and technological and market developments.

CONSOLIDATED BALANCE SHEETS

	July 31, 2001 \$	April 30, 2001 \$
(in thousands of Canadian dollars)		
ASSETS	(Unaudited)	(Audited)
Current		
Cash and cash equivalents	5,208	9,953
Short-term investments	47,500	45,839
Amounts receivable	89	148
Prepaid expenses and deposits	283	258
Total current assets	53,080	56,198
Capital assets	1,610	1,599
Intangible assets	1,803	1,752
	56,493	59,549
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	5,946	4,523
Total current liabilities	5,946	4,523
Contingencies [note 3]		
Shareholders' equity		
Share capital [note 2]	95,771	95,722
Shares to be issued [note 5]	698	613
Deficit	(45,922)	(41,309)
Total shareholders' equity	50,547	55,026
	56,493	59,549

See accompanying notes

On behalf of the Board:



COLIN R. MALLET
Director



WILLIAM J. (BUD) FORAN
Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

	Three months ended July 31	
	2001	2000
(Unaudited—in thousands of Canadian dollars except per share amounts)	\$	\$
REVENUE		
Interest income	666	790
EXPENSES		
Research and development	4,371	1,877
General and corporate	908	666
	5,279	2,543
Loss	(4,613)	(1,753)
Deficit, beginning of period	(41,309)	(29,600)
Deficit, end of period	(45,922)	(31,353)
Loss per common share [note 2[c]]	(0.12)	(0.05)
Weighted average number of common shares outstanding [note 2[c]]	38,187	34,524

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended July 31	
	2001	2000
(Unaudited—in thousands of Canadian dollars)	\$	\$
OPERATING ACTIVITIES		
Loss for the period	(4,613)	(1,753)
Items not affecting cash:		
Amortization	163	118
Write-down of capitalized patent costs	40	—
Loss on disposal of capital assets	20	—
Changes in non-cash working capital items relating to operating activities:		
Accrued interest on short-term investments	(122)	(136)
Amounts receivable	59	(4)
Prepaid expenses and deposits	(25)	(5)
Accounts payable and accrued liabilities	1,438	(135)
Cash flows used in operating activities	(3,040)	(1,915)
FINANCING ACTIVITIES		
Issuance of common shares, net of issue costs	49	635
Issuance of special warrants, net of issue costs	(19)	(146)
Cash flows provided by financing activities	30	489
INVESTING ACTIVITIES		
Funds from (purchase of) short-term investments	(1,539)	(113)
Purchase of capital assets	(121)	(42)
Intangible asset expenditures	(75)	(336)
Cash flows provided by (used in) investing activities	(1,735)	(491)
Increase (decrease) in cash and cash equivalents	(4,745)	(1,917)
Cash and cash equivalents, beginning of period	9,953	45,015
Cash and cash equivalents, end of period	5,208	43,098
Supplemental cash flow information		
Increase in intangible assets for common shares to be issued	85	503

See accompanying notes

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2001 (Unaudited—Canadian dollars)

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and on a basis consistent with the Company's most recent annual audited financial statements for the year ended April 30, 2001. These interim financial statements and notes do not include all disclosures required for annual financial statements and should be read in conjunction with the annual audited consolidated financial statements of the Company.

2. SHARE CAPITAL

[a] Issued and outstanding

	Number of Common Shares (thousands)	Amount \$ (thousands)
Balance, April 30, 2001	39,359	95,722
Issued for cash pursuant to:		
Exercise of stock options	15	49
Balance, July 31, 2001	39,374	95,771

[b] Stock options

Stock option transactions and the number of stock options outstanding with respect to both the 1996 and 2000 Stock Option Plans are summarized as follows:

	Weighted Average Number of Common Shares (thousands)	Exercise Price \$
Balance, April 30, 2001	1,702	3.97
Options granted	32	2.17
Options exercised	(15)	3.30
Options forfeited/expired	(882)	3.53
Balance, July 31, 2001	837	4.38

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS, CONTINUED

Three months ended July 31, 2001 (Unaudited—Canadian dollars)

[c] Loss per common share

Loss per common share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period, excluding shares held in escrow or other contingently issuable common shares. Since the Company's stock options, common shares to be issued, escrow shares, underwriter options and warrants are anti-dilutive, fully diluted loss per common share has not been presented.

3. CONTINGENCIES

A former executive commenced an action against the Company on June 25, 2001, alleging that the Company has certain obligations with respect to stock options that were granted to the executive, including approximately 1.6 million stock options that have been recorded as forfeited/expired by the Company. The former executive is claiming unspecified damages, costs and interest. The litigation against the Company is in the very early stages and the Company cannot predict its outcome or any possible financial losses that it may incur as a result of the litigation. The Company does not expect any losses, if any, to have a material effect on the Company's operating results. Management believes the litigation against the Company is without merit and intends to defend the action vigorously.

4. COMPARATIVE FIGURES

Certain comparative figures have been reclassified from statements previously presented to conform to the presentation adopted in the current period.

5. SUBSEQUENT EVENTS

Subsequent to July 31, 2001, the Company issued 100,000 common shares recorded at July 31, 2001 as "Shares to be issued" with a fair value of \$587,000.