



ADVANCING THERAPY.
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ENRICHING LIFE!

FIRST QUARTER REPORT

July 31, 2006



The following information should be read in conjunction with the Company's April 30, 2006 audited consolidated financial statements and related notes included therein; Management's Discussion & Analysis of Financial Condition and Results of Operations for the year ended April 30, 2006; and the interim unaudited consolidated financial statements for the three months ended July 31, 2006, including the related notes therein. All amounts unless indicated otherwise are expressed in Canadian dollars. The discussion and analysis contained in this Management Discussion & Analysis is as of September 13, 2006. Additional information on the Company including the Company's Annual Information Form is available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") contains forward-looking statements or information within the meaning of the United States Private Securities Litigation Reform Act of 1995 and applicable Canadian securities legislation. All statements or information other than statements of historical fact may be deemed to be forward-looking statements or information. Forward-looking statements frequently, but not always, use the words "intends", "plans", "believes", "anticipates" or "expects" or similar words; that events "will", "may", "could" or "should" occur; and/or include statements or information concerning our strategies, goals, plans and expectations.

Forward-looking statements or information in this MD&A include, but are not limited to statements or information concerning: omiganan 1% gel phase III results in the second half of 2007 and Cadence to submit for omiganan 1% gel marketing approvals in the United States and Europe in the first half of 2008; Cadence pursuing pediatric indication for omiganan 1% gel; celgosivir phase II non-responder combination 12-week treatment results in late October to mid November 2006; celgosivir treatment-naïve combination therapy study 4 week interim results in late 2006 and 12 week results in the first half of 2007; omiganan phase II rosacea trial initiated and completed by Cutanea in 2007; MX-4509 data from two non-clinical studies by the end of 2006 with clinical studies to follow as deemed appropriate; MX-2401 manufacturing for GLP non-clinical studies to be completed by the end of 2006; the duration of the MX-2401 GLP studies required for a Clinical Trial Application being approximately 12 months; up to US\$100,000 in milestones being achieved and payable in the next 12 months pursuant to the Company's preferred shares; the Company continuing to advance its highest priority programs while operating within an annual burn rate of \$11 million to \$13 million; and the Company's financial resources being sufficient to fund operations into the third quarter of calendar 2007.

We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements or information and you should not place undue reliance on our forward-looking statements or information. Factors that could cause actual events or results expressed or implied by such forward looking statements to differ materially from any future results expressed or implied by such statements or information include, but are not limited to: dependence on corporate collaborations; uncertainties related to early stage of technology and product development; uncertainties as to the requirement that a drug be found to be safe and effective after extensive clinical trials and the possibility that the results of such trials, if commenced and completed, will not establish the safety or efficacy of our products; risks relating to requirements for approvals by government agencies such as the FDA and/or Health Canada before products can be tested in clinical trials and ultimately marketed; the possibility that such government agency approvals will not be obtained in a timely manner or at all or will be conditioned in a manner that would impair our ability to advance development and/or market the product successfully; uncertainties as to future expense levels and the possibility of unanticipated costs or expenses or cost overruns, the possibility that opportunities will arise that require more cash than presently anticipated and other uncertainties related to predictions of future cash requirements; management of growth; dependence on key personnel; the possibility that we will not successfully develop any products; the possibility that advances by competitors will cause our proposed products not to be viable, the risk that our patents could be invalidated or narrowed in scope by judicial actions or that our technology could infringe the patent or other intellectual property rights of third parties; the possibility that any products successfully developed by us will not achieve market acceptance; and other risks and uncertainties which may not be described herein. Certain of these factors and other factors are described in detail in the Company's Annual Information Form and Annual Report on Form 20-F and other filings with the Canadian securities regulatory authorities and the U.S. Securities & Exchange Commission.

Forward-looking statements are based on our current expectations and MIGENIX assumes no obligations to update such information to reflect later events or developments.



BUSINESS OVERVIEW

We are in the business of researching, developing and commercializing drugs in the areas of infectious and degenerative diseases. We do not currently have any products approved for sale and our operations consist principally of research and development activities to advance our drug candidates through the product development and regulatory processes to obtain marketing approval. Our drug development programs can be classified by technology/class of compounds, disease area, product formulation/method of delivery, and stage of development, as follows:

ANTI-INFECTIVE DRUG DEVELOPMENT PROGRAMS

Program Name and Compound Class	Disease Area	Stage of Development
Omiganan 1% gel (cationic peptide). Also known as CPI-226 and MX-226.	Prevention of catheter-related infections (topical).	Phase III study in United States and Europe in progress. Special Protocol Assessment (SPA) agreement with the US FDA. One phase III study completed in the United States. Out-licensed the North American and European development and commercialization rights for the topical treatment or prevention of device-related, burn-related or surgery-related infections to Cadence Pharmaceuticals. Cadence expects phase III results in the prevention of catheter-related infections in the second half of 2007 and to submit for marketing approvals in the United States and Europe in the first half of 2008.
Omiganan for the treatment of dermatological diseases (cationic peptide). Also known as MX-594AN and CLS-001.	Rosacea and other dermatological diseases (topical)	Completed two phase II studies in the United States for the treatment of acne. Out-licensed global development and commercialization rights to Cutanea Life Sciences. Cutanea has selected rosacea as lead indication for development and plans to initiate and complete a phase II trial in 2007.
Celgosivir (also known as Mx-3253)	Treatment of chronic Hepatitis C Virus infections (oral)	Phase II in Canada. Completed phase IIa monotherapy trial. Two phase II studies testing celgosivir in combination with peg-interferon with and/or without ribavirin are in progress. Data from these two studies are expected by the end of 2006.
MX-2401 (amphotycin-related lipopeptide)	Treatment of serious gram positive infections (intravenous)	Preclinical; lead candidate being advanced; \$9.3 million funding commitment from Technology Partnerships Canada. Manufacturing for GLP non-clinical studies to be completed by the end of 2006.
SB-9000 (dinucleotide) (formerly MX-1313)	Treatment of Hepatitis B Virus infections	Preclinical. Out-licensed to Spring Bank Technologies.
HCV Non-nucleoside (HCVnn) (small molecule)	Treatment of chronic Hepatitis C Virus infections	Preclinical; lead series of compounds identified with development work focused on optimizing oral bioavailability and further testing of compounds to generate a lead development candidate

DEGENERATIVE AND METABOLIC DRUG DEVELOPMENT PROGRAMS

Program Name and Compound Class	Disease Area	Stage of Development
MX-4509 (17a-estradiol sodium sulfate)	Treatment of neurodegenerative diseases (oral)	Evaluating potential orphan indications in non-clinical studies. Data from the non-clinical studies expected by the end of 2006. One phase I trial completed.
MX-4565 (small molecule)	Treatment of ophthalmic diseases (eg retinitis pigmentosa) and neurodegenerative diseases (e.g. Parkinson's disease, Alzheimer's disease)	Preclinical. Evaluating potential in Parkinson's and other diseases.
MX-4042 (small molecule)	Treatment of arthritis	Preclinical



DEVELOPMENT PROGRAMS

Omiganan 1% gel: Prevention of Catheter-Related Infections

In June 2005 our partner for the North American and European development and commercialization of omiganan 1% gel (also known as MX-226 or CPI-226), Cadence Pharmaceuticals, Inc. (Cadence), and the FDA reached a written agreement on a protocol for a phase III clinical trial of omiganan 1% gel which, if successful, would support US marketing approval for the prevention of local catheter site infections. This agreement was reached under the FDA's special protocol assessment ("SPA") process, which establishes a written agreement between the FDA and the sponsoring company regarding clinical trial design, endpoints, study conduct, data analysis, and other elements of the study protocol. It is intended to provide agreement that, if the trial is executed per the protocol and pre-specified trial endpoints are achieved, they may serve as the primary basis for an efficacy claim in support of a NDA. In general, the SPA agreement is considered binding on both the FDA and the study sponsor.

Cadence initiated United States enrollment in a multi-national pivotal phase III study of omiganan 1% gel in August 2005 pursuant to the SPA. European enrollment in the study was initiated in January 2006. This confirmatory phase III trial is a randomized, Evaluation Committee-blinded study to evaluate the effectiveness of omiganan 1% gel vs. 10% povidone-iodine for the prevention of catheter-related infections in approximately 1,250 hospitalized patients with central venous catheters. The primary efficacy endpoint of the study is to evaluate whether omiganan 1% gel is superior to 10% povidone-iodine treatment in reduction of local catheter site infections in patients requiring central venous catheterization. Other secondary objectives of this study include assessing the effectiveness of omiganan 1% gel in preventing catheter colonization, catheter-related bloodstream infections and all-cause bloodstream infections in patients requiring central venous catheterization, as well as gathering additional safety data on omiganan 1% gel. Cadence expects to complete the study in the second half of 2007. Cadence has also advised that they plan to submit an NDA to the FDA and a Marketing Authorization Application to European regulatory authorities, for marketing approval in the US and Europe respectively, in the first half of 2008. Additionally, Cadence intends to also pursue, as a post marketing application, a pediatric indication for omiganan 1% gel in the prevention of catheter-related infections (current and prior studies have been in adult patients and some studies in pediatric patients will likely be required for expansion to pediatric population).

In the first phase III study (completed July 2003 in the United States) with over 1,400 patients, omiganan 1% gel demonstrated a statistically significant 49% reduction in local catheter site infections ($p = 0.004$), and a statistically significant 21% reduction in catheter colonization ($p = 0.002$), both secondary endpoints in the study. In the study there was also a statistically significant 51% reduction in catheter replacements ($p = 0.002$). Statistical significance was not reached in the study for the primary endpoint of catheter-related bloodstream infections.

Under the terms of the Collaboration and License agreement with Cadence, MIGENIX can now receive up to US\$27 million in development and commercialization milestone payments starting with the US and European regulatory submission process; and a double-digit royalty on net sales (see "LIQUIDITY and CAPITAL RESOURCES" for May 2006 financing involving these royalties). In addition, Cadence funds the clinical, regulatory, and commercialization costs related to omiganan 1% gel and is responsible for manufacturing. MIGENIX has initiated activities directed at securing a development and commercialization partner for omiganan 1% gel in Japan and other territories outside of North America and Europe.

Celgosivir: Treatment of Chronic Hepatitis C virus ("HCV") Infections

The current standard of care treatment regimen for genotype 1 HCV infections (the most common North American genotype) is a combination therapy approach (combination of pegylated alpha interferon and ribavirin) which is effective in only about 40% to 50% of patients. Preclinical studies have demonstrated synergistic activity between celgosivir, interferon alpha and ribavirin, as well as other anti-HCV compounds, in a BVDV surrogate model for HCV infections. Celgosivir has also been shown to inhibit HCV and BVDV to a similar extent in vitro. These data provide the basis for the Company's strategy to develop celgosivir as a combination therapy with pegylated alpha interferon and/or other HCV products for the treatment of chronic HCV infection.

MIGENIX's celgosivir clinical development activities to date include three phase II clinical studies in patients infected with chronic HCV genotype 1: (i) a monotherapy study (completed in September 2005); (ii) a combination therapy study in patients previously non-responsive or partially responsive to interferon-based therapy ("non-responders"); and (iii) a combination therapy study in treatment-naïve patients, which includes an assessment of viral kinetics:

Phase IIa Monotherapy Study

The phase IIa monotherapy study was an open-label, randomized, dose-response (three groups), 12-week study in treatment-naïve and interferon-intolerant chronic HCV genotype 1 patients. Enrollment started in October 2004 and 43 patients participated. The results demonstrated that celgosivir was well-tolerated with generally mild to moderate, reversible side effects, and no serious adverse events were observed. In two patients an antiviral effect (measured by the decrease from baseline of HCV RNA) of 1.0 log₁₀ (90% clearing of the virus) or greater reduction in viral load was observed, with one patient achieving a peak reduction in HCV RNA of 2.6 log₁₀ (99.8% clearing of the virus). The mean decrease in HCV RNA did not reach clinical significance. The Company concluded that the phase IIa monotherapy results, along with the preclinical synergy data generated to date (synergistic activity between celgosivir, interferon alpha and ribavirin), support the Company's combination therapy development strategy.

Phase II Combination Therapy Study (non-responder patients)

A phase II combination study commenced in November 2005, with full enrollment reached in June 2006 and final results of the study expected in late October to mid November 2006. The study is a multi-center, active-controlled, 12-week evaluation of efficacy and safety in 57 non-responder patients randomly assigned to one of three treatment arms: (i) celgosivir plus peginterferon alfa-2b plus ribavirin (3-way combination); (ii) celgosivir plus peginterferon alfa-2b (2-way combination); and (iii) celgosivir placebo plus peginterferon alfa-2b plus ribavirin (control). Patients completing 12 weeks of treatment in the study have the option to participate for up to an additional 36 weeks in an extension study. In consultation with their physician the patient can elect to continue on with their current treatment or, if on the celgosivir peginterferon 2-way combination or the control treatments, can switch to the celgosivir peginterferon ribavirin 3-way combination treatment. Of the 57 patients enrolled in the initial 12-week treatment study, 7 patients discontinued treatment prior to completion of 12-week treatment period, mainly due to interferon-related intolerance. Of the 50 patients completing the initial 12-week treatment study, all 50 enrolled in the extension study and 37 patients are continuing treatment in the extension study.

In July 2005 we completed a Material Transfer and License Option agreement with Schering-Plough providing for (a) the supply of PEGETRON[®] (peginterferon alfa-2b powder plus ribavirin) for the phase II non-responder study, (b) certain technical and laboratory support and other services for the study, and (c) certain limited rights for Schering's review of clinical trial results and for the negotiation of a license agreement. As of July 31, 2006, the Company estimates that the value of the PEGETRON[®] and lab testing services received by the Company to be approximately \$0.9 million and the Company has recorded this non-monetary consideration and expense at a net cost of \$nil in its research and development expenses (\$0.2 million for the three months ended July 31, 2006; and \$0.7 million for the year ended April 30, 2006).

Phase II Combination Therapy Study (treatment-naïve patients)

In May 2006 the Company received a Notice of Authorization from Health Canada allowing us to begin a phase II combination study of celgosivir in treatment-naïve patients with chronic HCV (genotype 1) infection designed to determine the efficacy, safety, tolerability and pharmacokinetics of celgosivir in combination with peginterferon alfa-2b, with ribavirin. In July 2006 we received approval for an amended protocol to include two treatment arms rather than the previous three-arm design. This phase II study is a 12-week randomized, active-controlled study in up to 20 patients in two treatment arms: (i) celgosivir plus peginterferon alfa-2b plus ribavirin (3-way combination); and (ii) peginterferon alfa-2b plus ribavirin (control). As part of the study, the viral kinetics of celgosivir will be evaluated. Four week interim results of the study are expected in late 2006 and 12 week results are expected in the first half of 2007.

Omiganan for the Treatment of Dermatological Diseases

A license agreement for the development and commercialization of omiganan for the treatment of dermatological diseases was executed on December 7, 2005 with Cutanea Life Sciences, Inc., ("Cutanea") a private, dermatological pharmaceutical company based in metropolitan Philadelphia, Pennsylvania.



Pursuant to the license agreement, MIGENIX can receive up to approximately US\$21 million in development and commercialization milestone payments, as well as royalties on net sales (see "LIQUIDITY and CAPITAL RESOURCES" for May 2006 financing involving these royalties). Cutanea received exclusive worldwide rights to develop and market omiganan and its analogues for dermatological indications. Cutanea is responsible for funding all development activities including formulation, clinical, regulatory, and commercialization costs.

Cutanea has advised the Company that it is pursuing rosacea as its first indication for development and plans to initiate and complete a phase II clinical trial in 2007. Prior to initiating the phase II trial Cutanea will need to: complete formulation work; manufacture the drug; hold a pre-IND meeting with the FDA; submit an IND for the phase II trial; and all other activities necessary to initiate a clinical trial.

MX-4509: Treatment of Neurodegenerative Diseases

MX-4509 (17 α -estradiol sodium sulfate) is being evaluated for its therapeutic potential in certain neurodegenerative indications. A non-clinical study in a potential neurodegenerative orphan indication was initiated in October 2005 and a study in a second indication started in May 2006, with clinical studies to follow, as deemed appropriate, based on the non-clinical data. These non-clinical data are expected by the end of 2006. MX-4509 was well tolerated in an initial phase I clinical study and has demonstrated activity in multiple non-clinical models used for assessing drugs for neuroprotection.

MX-2401: Treatment of Serious Gram-positive Bacterial Infections

MX-2401 is being developed for the treatment of serious Gram-positive bacterial infections. On March 31, 2005 we entered into an agreement with the Government of Canada under the Technology Partnership's Canada (TPC) program which will provide up to \$9.3 million in funding for the development of MX-2401 through the completion of the first phase III clinical trial.

The Company is developing the process for manufacturing MX-2401 on a scale that will provide sufficient quantities for the Good Laboratory Practices ("GLP") non-clinical toxicity studies required to support moving into clinical development. This process development work and the manufacturing are projected to complete by the end of 2006 and the GLP non-clinical studies required for a Clinical Trial Application ("CTA") could be completed approximately 12 months thereafter. Prior to initiating clinical trials with MX-2401 the Company will need to initiate and complete the manufacture of MX-2401 for the clinical study, submit a CTA and obtain approval from Health Canada for the clinical study, and various other activities.

Other Research and Development Programs

The Company is carrying out work in other selected earlier stage programs. Work in the HCV non-nucleoside ("HCVnn") program is focused on optimizing oral bioavailability and further testing of compounds to generate a lead development candidate. Work in the Company's MX-4565 (neurodegenerative diseases) program includes: (i) internal preclinical research; and (ii) Parkinson's disease related research of a collaborator supported by the Michael J. Fox Foundation. Work in both the HCVnn and MX-4565 programs is focused on advancing the compounds into animal studies and non-clinical development.

CRITICAL ACCOUNTING POLICIES

The Company's audited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and the reporting currency is Canadian dollars. These accounting principles require the Company to make certain estimates and assumptions. The Company believes that the estimates and assumptions upon which it relies are reasonable based upon information available at the time that these estimates and assumptions are made. Actual results could differ from these estimates. Areas of significant estimates include recognition of revenue, amortization of intangible assets, assessment of the carrying value of intangible assets, and stock-based compensation. A reconciliation of amounts presented in accordance with United States generally accepted accounting principles ("US GAAP") is described in Note 18 to the audited consolidated financial statements for the year ended April 30, 2006.

The significant accounting policies that the Company believes are the most critical in fully understanding and evaluating the reported financial results include the following:



Revenue recognition

Revenue to date has primarily been derived from initial license fees and research and development collaboration payments from licensing arrangements. Initial fees and milestone fees received which require the Company's ongoing involvement are deferred and amortized into income over the term of the underlying product development period. A change in the underlying product development period from the originally estimated period may result in a longer or shorter period that the initial fees are amortized into income, decreasing or increasing income respectively. Research and development collaboration revenues generally compensate the Company for non-clinical and clinical expenses related to development programs under collaborative/licensing agreements for certain product candidates of the Company, and are recognized as revenue when the research and development activities are performed under the terms of the agreements.

Research and development costs

Research and development costs consist of direct and indirect expenditures related to the Company's research and development programs. Research and development costs are expensed as incurred unless they meet generally accepted accounting criteria for deferral and amortization. The Company assesses whether costs have met the relevant criteria for deferral and amortization at each reporting date. No development costs have been deferred to date.

Under US GAAP, costs to purchase rights to unproven technology which may not have alternate future uses are expensed as research and development. Under Canadian GAAP, the purchase cost of such rights is generally capitalized as an intangible asset. Any change in the future use or impairment of unproven technology may have a material impact on the Company's Canadian GAAP financial statements.

Intangible assets

Intangible assets are comprised of technology licenses and acquired technology and include those acquired in exchange for equity instruments issued by the Company. Intangible assets are amortized on a straight-line basis over the estimated useful life of the underlying technologies of ten years. The Company determines the estimated useful lives for intangible assets based on a number of factors such as legal, regulatory or contractual limitations; known technological advances; anticipated demand; and the existence or absence of competition. The Company reviews the carrying value of its intangible assets on a quarterly basis to determine if there has been a change in any of these factors. A significant change in these factors may warrant a revision of the expected remaining useful life of the intangible asset, resulting in accelerated amortization or an impairment charge, which would impact earnings.

Stock-based compensation

The Company grants stock options to executive officers and directors, employees, consultants and advisory board members pursuant to its stock option plans. The Company records all stock-based awards to the Company's executive officers, directors and employees granted, modified or settled since May 1, 2003, and all stock-based awards to non-employees granted, modified or settled since May 1, 2002, at fair value. The fair value of stock options is estimated at the date of grant using the Black-Scholes Option Pricing Model and is amortized over the vesting terms of the stock options. The Company discloses the proforma effects to the loss and loss per common share for the period as if the fair value method had been used for awards to executive officers, directors and employees granted, modified or settled during the period May 1, 2002 to April 30, 2003. The Black-Scholes option pricing model is based on several subjective assumptions including the expected life of the option and the expected volatility at the time the options are granted. Changes in these assumptions can materially affect the measure of the estimated fair value of the stock options and hence, the results of operations. Stock-based compensation is likely to change from period to period as further options are granted and adjustments made for stock options forfeited.

ADOPTION NEW ACCOUNTING POLICY

As a result of the convertible royalty participation unit financing completed May 3, 2006 we adopted the accounting policy for the convertible royalty participation units as described in "LIQUIDITY and CAPITAL RESOURCES" and note 2 to the July 31, 2006 unaudited interim consolidated financial statements.



SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

The following table provides summary financial data for our last eight quarters:

<i>(Expressed in thousands, except per share amounts)</i>	Three months ended,			
	July 31, 2006 ("Q1/07")	April 30, 2006 ("Q4/06")	January 31, 2006 ("Q3/06")	October 31, 2005 ("Q2/06")
Revenue	\$ -	\$ -	\$ 305	\$ -
Operating loss	\$ (2,356)	\$ (3,111)	\$ (2,327)	\$ (3,407)
Loss	\$ (2,486)	\$ (3,032)	\$ (2,232)	\$ (3,314)
Basic and diluted loss per common share	\$ (0.03)	\$ (0.05)	\$ (0.03)	\$ (0.04)
Weighted average number of common shares outstanding	74,299	74,258	74,258	74,258

	Three months ended,			
	July 31, 2005 ("Q1/06")	April 30, 2005 ⁽¹⁾ ("Q4/05")	January 31, 2005 ⁽¹⁾ ("Q3/05")	October 31, 2004 ⁽¹⁾ ("Q2/05")
Revenue	\$ 269	\$ 11	\$58	\$2,089
Operating loss	\$ (2,834)	\$ (3,211)	\$ (3,289)	\$ (947)
Loss	\$ (2,772)	\$ (3,137)	\$ (3,181)	\$ (992)
Basic and diluted loss per common share	\$ (0.04)	\$ (0.05)	\$ (0.05)	\$ (0.02)
Weighted average number of common shares outstanding	69,440	59,802	59,794	59,641

(1) The Revenue figures for Q2, Q3 and Q4 of Fiscal 2005 were reclassified in Q1 of Fiscal 2006 from those originally reported to reflect the Company's reclassification of certain cost recoveries from revenue to an offset to research and development expenses.

The primary factors affecting the magnitude of the Company's operating losses and losses have been research and development expenses (particularly clinical program development costs) not funded by a partner, licensing revenues and write-downs in intangible assets. The operating loss and loss in Q1/07 are lower than Q4/06 due principally to lower research and development costs in Q1/07 (Q1/07: \$1.3 million; Q4/06: \$1.8 million); and lower general and corporate costs in Q1/07 (Q1/07: \$0.8 million; Q4/06: \$1.0 million). The operating loss and loss in Q3/06 was lower than previous quarters and Q4/06 due to lower research and development costs and \$0.2 million in licensing revenue pursuant to the omiganan license agreement with Cutanea Life Sciences. The operating loss and loss in Q2/05 were significantly lower than previous quarters as a result of \$2.1 million in licensing revenue pursuant to the omiganan license agreement with Cadence Pharmaceuticals.

RESULTS OF OPERATIONS

MIGENIX commenced operations in January 1993 and has devoted its resources to the research and development of experimental new drug candidates. See "BUSINESS OVERVIEW" and "DEVELOPMENT PROGRAMS" for description of the Company's business, the drug candidates being developed and current development activities, development and commercialization agreements, and near-term milestones. No product candidates being developed by MIGENIX have been approved to be marketed commercially to date. MIGENIX has been unprofitable since its formation incurring significant operating losses each year and has incurred a cumulative deficit of \$111.2 million to July 31, 2006.

For the three months ended July 31, 2006 ("Q1/07"), MIGENIX incurred a loss of \$2.5 million (Q1/06: \$2.8 million) or \$0.03 (Q1/06: \$0.04) per common share. The decrease in the Q1/07 loss compared to the Q1/06 loss is principally



attributable to lower research and development expenses in Q1/07 (see "Operating Expenses – Research and Development" below) offset by the accretion expense on the convertible royalty participation units issued in May 2006 (see "Other Income and Expenses").

We have no fixed dividend policy and have not paid dividends since our incorporation. The payment of dividends is subject to the discretion of the board of directors and will depend, among other factors, on our earnings, capital requirements and operating and financial condition. We currently intend to retain future earnings, if any, to finance the growth and development of our business and do not intend to pay any dividends on our common shares or preferred shares in the foreseeable future.

Revenues

During Q1/07 the Company had no licensing revenue (Q1/06: \$nil) and no research and development collaboration revenue (Q1/06: \$0.3 million). Research and development collaboration revenues in Q1/06 were principally pursuant to the sale of omiganan drug substance to Cadence.

Operating Expenses

Operating expenses decreased in Q1/07 to \$2.4 million (Q1/06: \$3.1 million). The decrease in Q1/07 operating expenses is principally due to a decrease in research and development costs (see "Research and Development" below).

Research and Development

Research and development expenses decreased in Q1/07 to \$1.3 million (Q1/06: \$2.0 million). Research and development expenses include: (1) research and development personnel costs; (2) clinical development program costs; (3) patent-related costs; and (4) other research and development costs.

Research and development personnel costs for Q1/07 were \$0.6 million (Q1/06: \$0.8 million). The decrease in Q1/07 was primarily due to reduced head count as a result of the Company's cost reduction steps in May and June 2005 and ongoing cost containment measures..

Clinical program development costs in Q1/07 were \$0.4 million (Q1/06: \$0.6 million) and included \$0.4 million in costs in the celgosivir program (Q1/06: \$0.4 million). The decrease in clinical program development costs from Q1/06 to Q1/07 was primarily due to a decrease in MX-4509 program costs resulting from the Q1/06 decision to pursue potential orphan indications, and not proceeding with a planned phase I/II trial in Alzheimer's patients. Q1/07 costs in the MX-4509 program were less than \$0.1 million (Q1/06: \$0.1 million).

Patent-related costs in Q1/07 were \$0.2 million (Q1/06: \$0.2 million).

Other research and development costs in Q1/07 were \$0.1 million (Q1/06: \$0.4 million) and reflect product development costs for programs that are not at the clinical stage of development and costs that are not allocated to specific programs. Other research and development costs are expected to increase during the remainder of Fiscal 2007 as the Company advances its preclinical programs (see "DEVELOPMENT PROGRAMS – MX-2401: Treatment of Serious Gram-positive Bacterial Infections") and "DEVELOPMENT PROGRAMS – Other Research and Development Programs").

General and Corporate

General and corporate expenses in Q1/07 were \$0.8 million (Q1/06: \$0.8 million). Personnel costs were \$0.5 million in Q1/07 (Q1/06: \$0.6 million).

Amortization

Amortization expense in Q1/07 for capital assets was \$0.1 million (Q1/06: \$0.1 million).

Amortization expense in Q1/07 for intangible assets was \$0.2 million (Q1/06: \$0.2 million).



Other Income and Expenses

Other income and expenses includes three principal items: (1) interest income generated from investments of the Company's cash balances; (2) accretion expense related to the convertible royalty participation unit financing completed in Q1/07 (see "LIQUIDITY and CAPITAL RESOURCES"); and (3) foreign exchange gains and losses on the Company's United States ("US") dollar denominated cash and cash equivalents, amounts receivable and accounts payable balances. See "FINANCIAL INSTRUMENTS AND RISKS".

Interest income for Q1/07 was \$0.1 million (Q1/06: \$0.1 million). The average rate of return for Q1/07 was 3.7% (Q1/06: 2.3%).

Accretion expense related to the convertible royalty participation units (see "LIQUIDITY and CAPITAL RESOURCES") for Q1/07 was \$0.3 million (Q1/06: \$nil). This accretion expense is a non-cash expense resulting from accreting the debt component of the convertible royalty participation units to the maximum royalties payable of \$29.5 million (reduced for actual royalties paid and any units converted into common shares) over the estimated royalty payment term using the effective interest method (see note 2 to July 31, 2006 unaudited interim consolidated financial statements).

The foreign exchange gains and losses were nominal for each of Q1/07 and Q1/06.

Capital and Intangible Asset Expenditures

Capital asset expenditures in Q1/07 were \$0.1 million (Q1/06: nominal).

Intangible assets at July 31, 2006 include acquired technology and capitalized technology license costs for the Company's neurodegenerative (MX-4509, MX-4565 and MX-4042), lipopeptide (MX-2401), celgosivir, and HBV (SB-9000) programs. The \$5.4 million carrying value of these intangible assets at July 31, 2006 does not necessarily reflect present or future values of the underlying programs/technologies and the ultimate amount recoverable by the Company in respect of these assets will be dependent upon the successful development and commercialization of products based on these assets and/or out-licensing of the programs/technologies to third parties (see "RISKS and UNCERTAINTIES").

Technology license costs capitalized in Q1/07 were \$nil (Q1/06: \$nil).

Acquired technology costs capitalized in Q1/07 were \$nil (Q1/06: \$nil).

LIQUIDITY AND CAPITAL RESOURCES

As of July 31, 2006, the Company had cash, cash equivalents and short term investments of \$14.0 million (April 30, 2006: \$9.4 million) and the Company's net working capital was \$12.4 million (April 30, 2006: \$6.3 million). The \$6.1 million increase in net working capital from April 30, 2006 to July 31, 2006 is primarily attributable to the \$7.7 million in net proceeds from the May 2006 financing (see below), less the loss of \$1.8 million (excluding non-cash expenses: amortization, stock-based compensation and accretion of the convertible royalty participation units) for the three months ended July 31, 2006. The Company's cash equivalents and short term investments are invested in high-grade liquid financial instruments with maturity dates, selected with respect to the expected timing of expenditures to fund operations (not to exceed three years) and prevailing and expected interest rates (see "FINANCIAL INSTRUMENTS AND RISKS").

MIGENIX has financed its operations to date primarily through the sale of equity securities. On May 3, 2006 the Company completed a financing of \$8.8 million relating to a portion of the future royalties from the Company's license agreements with Cadence Pharmaceuticals (see "DEVELOPMENT PROGRAMS – Omiganan 1% gel: Prevention of Catheter-Related Infections") and Cutanea Life Sciences (see "DEVELOPMENT PROGRAMS – Omiganan for the Treatment of Dermatological Diseases"). A total of 29,465 royalty units were issued at a price of \$300 per unit. Each unit entitles the purchaser to receive up to \$1,000 of royalties under the license agreements to May 3, 2021. The \$1,000 of royalties per unit is as follows: [i] 75% of the royalties under the license agreements until \$300 of royalties is paid per unit; [ii] thereafter 50% of the royalties until a further \$300 of royalties is paid per unit; and [iii] thereafter 25% of the royalties until a further \$400 of royalties is paid per unit. The units contain features whereby the Company or the unit holders may elect to convert the units into the Company's common shares (see "OUTSTANDING SHARE DATA"). In the event there are no royalties under the license agreements there is no obligation for the Company to make any



payments to the unit holders. The Company's obligation to pay royalties from the license agreements and/or to issue common shares upon conversion of a unit terminates upon the earlier of: (i) the date \$1,000 of royalties has been paid in respect of the unit; (ii) the date the unit is converted into common shares; and (iii) May 3, 2021. The Company has provided the buyers (through a trustee) with a first-lien security interest over certain assets of the Company relating to the license agreements. The security interest can be acted on in the event of default by the Company including bankruptcy, non-payment of royalties received under the two license agreements, and certain other events. In the event of default the Company would become obligated to pay the unit holders \$1,000 per unit less the royalties paid in respect of the unit. In connection with completing the transaction the Company: [i] paid the agent a cash commission of \$0.7 million and issued to the agent warrants expiring May 3, 2009 for the purchase of 883,950 common shares at a price of \$0.50 per common share (see "OUTSTANDING SHARE DATA"); and [ii] incurred approximately \$0.4 million in legal, professional and other costs of which \$0.3 million were included in other assets at April 30, 2006. The warrants issued to the agents were determined to have a value of approximately \$0.2 million using the Black-Scholes option pricing model and have been recorded as contributed surplus. The \$7.5 million of net proceeds (\$7.7 million net proceeds less \$0.2 million allocated to contributed surplus for the agent's warrants) on issuance of the convertible royalty participation units has been classified in the Company's financial statements according to the separate equity and debt component parts using the relative fair value method resulting in: (1) \$4.6 million being allocated to Equity portion of Convertible Royalty Participation Units representing the pro-rata fair value of the conversion feature as determined by the Black-Scholes option pricing model and (2) \$2.9 million being allocated to the carrying value of the Convertible Royalty Participation Units. The \$2.9 million initial carrying value of the Convertible Royalty Participation Units will be accreted to the maximum royalties payable of \$29.5 million (reduced for actual royalties paid and any units converted into common shares) over the estimated royalty payment term using the effective interest method with the corresponding accretion expense being included in the statement of loss (see "RESULTS OF OPERATIONS – Other Income and Expenses").

In March 2005 the Company obtained a \$9.3 million funding commitment for the MX-2401 program from the TPC program (see "DEVELOPMENT PROGRAMS – MX-2401: Treatment of Serious Gram-positive Bacterial Infections"). As at July 31, 2006 the Company had expenditures qualifying for \$0.7 million of funding under this commitment of which \$0.6 million had been received and \$0.1 million was recorded as government assistance receivable (April 30, 2006 - \$0.7 million of funding under this commitment of which \$0.5 million had been received and \$0.2 million was recorded as government assistance receivable). The TPC funding covers 26% of eligible costs and a royalty is payable to TPC if the MX-2401 program is successful (determination of success includes the obtaining of marketing approval). The royalty payable, if any, is 1.75% of any post commercialization revenues of the Company during the eleven year period ending March 31, 2019 to a maximum of \$30.4 million. The royalty rate is reduced to 1.2% should the cumulative royalties reach \$20.3 million. If the cumulative royalties have not reached \$20.3 million by March 31, 2019 the royalty period will be extended to the earlier of: (i) March 31, 2023; and (ii) the cumulative royalties paid reaching \$20.3 million. Royalties, if any, that may be payable to TPC would be accounted for in the period in which it is determined that payment is likely.

MIGENIX believes that its funds on hand at July 31, 2006, together with ongoing cost containment measures and expected interest income, are sufficient to provide for operations into the third quarter of calendar 2007 before funds received, if any, from financing activities, the exercise of warrants and options, and existing or new license agreements. The Company will continue advancing its highest priority programs (see "RISKS AND UNCERTAINTIES") while operating within an annual burn rate of \$11 million to \$13 million. The magnitude of spending in the Company's development programs for Q3/07 forward will be dependent on the results of the various studies currently in progress (results expected by end of calendar 2006 in the celgosivir, MX-4509, and MX-2401 programs) and we may need to increase or decrease our annual burn rate in response to such results. The celgosivir results will also significantly impact the Company's prospects for licensing celgosivir and thus the generation of licensing and/or collaboration revenue from this program in Fiscal 2007 or Fiscal 2008. MIGENIX will need to raise additional funds in support of its operations and there is no assurance that such funds can be obtained (see "RISKS AND UNCERTAINTIES").

The Company has used redeemable/convertible preferred shares to facilitate the acquisition and in-licensing of new technologies and drug candidates. The preferred shares provide us with a vehicle to structure acquisitions and in-licensing transactions so as to lower the immediate cash cost to us, to pay milestones in the future in cash and/or common shares (at our option) based on the achievement of pre-determined product development milestones. The outstanding preferred shares (see "OUTSTANDING SHARE DATA") represent US\$14.6 million in potential future



milestone payments in the lipopeptide/MX-2401 (US\$675,000), polyene (US\$675,000), oligonucleotide/MX-1121 (US\$5,250,000), celgosivir (US\$4,000,000) and MitoKor/MX-4509/MX-4565/MX-4042 (US\$4,000,000) programs. During the next 12 months we estimate that 100,000 preferred shares (US\$100,000) could become convertible or redeemable pursuant to the achievement of certain of these milestones which would result in a charge of US\$100,000 to research and development expenses. Each series of preferred shares includes provision for the Company to redeem the entire series for US\$1, in which event any development milestones achieved subsequent to such redemption would be payable in cash. We anticipate that we will continue to use preferred shares for acquisitions and in-licensing in the future.

As at July 31, 2006, we had the following contractual obligations and commitments ⁽¹⁾ ⁽²⁾⁽³⁾:

Contractual Obligations	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Payments due by period <i>(Expressed in thousands of dollars)</i>					
Operating Leases ⁽⁴⁾	990	416	124	125	325
Purchase Obligations ⁽⁵⁾	2,576	2,576	-	-	-
Total Contractual Obligations	3,566	2,992	124	125	325

(1) Excludes US\$14.6 million in contingent milestone obligations pursuant to the Company's preferred shares discussed above.

(2) Excludes the following in respect of technology license and acquisition agreements: (i) up to an additional US\$3.7 million of contingent milestone payments (payable in cash) if certain drug development milestones are achieved; and (ii) royalties on product sales and/or sub-licensing revenues.

(3) Excludes \$29.5 million in respect of potential royalties pursuant to the convertible royalty participation units (see "LIQUIDITY and CAPITAL RESOURCES").

(4) Includes office and lab premises lease agreements and maintenance fees due under license agreements

(5) Represents obligations under research, manufacturing, and service agreements

OUTSTANDING SHARE DATA

As at September 13, 2006, there are:

- 74,301,648 (July 31, 2006: 74,299,148; April 30, 2006: 74,258,656) common shares outstanding. The 40,492 increase in common shares outstanding between July 31, 2006 and April 30, 2006 reflects the exercise of warrants and options;
- 14,600,000 (July 31, 2006: 14,600,000; April 30, 2006: 14,600,000) convertible redeemable preferred shares outstanding consisting of 350,000 Series A, 1,000,000 Series B, 5,250,000 Series C, 4,000,000 Series D and 4,000,000 Series E preferred shares. On the achievement of any of the pre-determined product development milestones underlying the preferred shares and the Company electing to convert, rather than redeem the applicable number of preferred shares for such milestone(s), the maximum number of common shares that could be issued under each series of preferred shares and the conversion price to be used to determine the number of common shares to be issued for such milestone(s) are as follows: Series A and B - 9,886,546 (average closing price 5 trading days prior to the conversion date, minimum price \$0.29); Series C (MX-1121 program is not active) - 9,501,401 (average closing price 5 trading days prior to the conversion date, minimum price \$0.88); Series D - 11,778,846 (average closing price 10 trading days prior to the conversion date); and Series E - 7,983,671 (average closing price 10 trading days prior to the conversion date). See "LIQUIDITY AND CAPITAL RESOURCES" for additional information on the Company's preferred shares;
- 29,465 (July 31, 2006: 29,465; April 30, 2006: nil) convertible royalty participation units outstanding (see "LIQUIDITY AND CAPITAL RESOURCES") convertible into up to 17,679,000 (July 31: 17,679,000; April 30, 2006: nil) common shares. The units are convertible at any time by the holders into the Company's common shares (initially 600 common shares per unit based at conversion price of \$0.50 per common share, with the number of common shares reduced proportionately for any royalties received by the unit holders). Additionally, the Company has an option to convert the units into common shares exercisable if the 20 trading day



weighted average closing price of the Company's common shares is \$2.00 or greater and the average daily trading volume is 30,000 or greater;

- stock options outstanding for the purchase of 4,586,425 (July 31, 2006: 4,608,425; April 30, 2006: 4,053,200) common shares at an average exercise price per common share of \$1.02 (July 31, 2006: \$1.02; April 30, 2006: \$1.12); and
- warrants outstanding for the purchase of 10,265,835 (July 31, 2006: 10,268,335; April 30, 2006: 9,424,551) common shares at a weighted average exercise price per common share of \$0.95 (July 31, 2006: \$0.95; April 30, 2006: \$0.99), as follows:

Number of Common Shares Issuable upon Exercise	Exercise Price(s) per Common Share	Expiry Date(s)
1,056,422	\$0.45	May 31, 2008
883,950 ⁽¹⁾	\$0.50	May 3, 2009
7,217,111	\$0.55	May 31, 2008
982,914 ⁽²⁾	\$3.00	December 3, 2007
125,438 ⁽³⁾	US\$13.21 to US\$17.75	March 20, 2007 to June 22, 2011
Total = 10,265,835	Average = \$0.95 ⁽⁴⁾	

(1) Issued as part of the May 2006 sale of royalty interest (see "LIQUIDITY AND CAPITAL RESOURCES")

(2) Warrants have an exercise feature allowing the warrant holders to elect to satisfy their obligation to pay the exercise price to the Company by accepting a lesser number of common shares

(3) These warrants were assumed by the Company as part of the acquisition of MitoKor. If these warrants are exercised the warrant holders would be entitled to receive up to US\$86,303 in milestone payments (milestones are the same as those for the Series E preferred shares), payable at the Company's option, in cash and/or common shares.

(4) Weighted average exercise price using closing September 13, 2006 exchange rate of US\$1.00 equals \$1.1203

On September 12, 2006 shareholders of the Company approved a new stock option plan and a deferred share unit plan subject to receiving Toronto Stock Exchange approval.

FINANCIAL INSTRUMENTS AND RISKS

We are exposed to market risks related to changes in interest rates and foreign currency exchange rates. The Company's investments in interest bearing financial instruments provide a fixed rate of return if held to maturity, therefore an increase or decrease in market interest rates can result in a decrease or increase in the market value of such investments respectively. The Company and its US subsidiaries purchase goods and services in US dollars and also earn revenues in US dollars. The Company does not use derivative instruments to hedge against interest rate or foreign exchange rate fluctuations.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.



RELATED PARTY TRANSACTIONS

During the Q1/07, the Company incurred legal fees of \$0.1 million (Q1/06: \$0.1 million) inclusive of sales taxes, payable to a law firm where the Secretary of the Company is a partner. This amount is payable under normal trade terms. All transactions with related parties are recorded at their exchange amounts and accounts payable are subject to normal trade terms. Included in accounts payable and accrued liabilities at July 31, 2006, is \$0.2 million (April 30, 2006: \$0.3 million) owed to this law firm.

RISKS AND UNCERTAINTIES

No product candidates being developed by MIGENIX have been approved to be marketed commercially and the Company has incurred significant operating losses in each year since inception. The Company's business entails significant risks, including the costs, time and uncertainties involved to obtain the required regulatory approvals to market new drugs, the uncertainties involved in preclinical and clinical testing to obtain the information required for regulatory approvals and for marketing of new drugs, the availability of capital and corporate alliances, managing and maintaining corporate collaborations, the degree of patent and other intellectual protection, intense competition and technological change. There can be no assurance that MIGENIX's research and development activities will result in any commercially viable products or profitability, and we expect to incur substantial losses over at least the next several years.

The Company has limited personnel and financial resources with which to optimally advance its programs. At July 31, 2006 the carrying value of the Company's intangible assets in respect of its development programs is approximately \$5.4 million. The Company may in the future determine that the carrying value of one or more programs should be written down based on:

- Termination of the program following preclinical and/or clinical testing results;
- Inability to secure development partner and/or funding to support the program;
- Carrying value of program exceeds estimated net recoverable value based on factors including projected cash flows;
- Loss of license rights for failure to perform in accordance with license agreements; and/or
- Decision not to pursue further development in the program

A write-down in the carrying value of one or more intangible assets in respect of the Company's development programs could have a significant non-cash impact on our operating results.

MIGENIX will need to raise additional funds in support of its operations and there is no assurance that such funds can be obtained. The Company's ability to raise capital is primarily dependent on equity markets, the Company's market capitalization and results in the Company's drug development programs. To maintain a sufficient cash position to fund its operations MIGENIX may need to delay or alter planned development work, sell or out-license certain development programs, and/or reduce other expenditures. Our future cash flows and capital requirements will depend on many factors, including, but not limited to, the following: the progress of our research and development programs including clinical trials and the magnitude and scope of these activities; our ability to establish and maintain corporate collaborations and licensing arrangements; the receipt and/or payment of milestone based payments pursuant to licensing agreements; the time and costs involved in obtaining regulatory approvals; the time and costs involved in scaling up the commercial manufacturing of our products; the amount of government and/or grant funding obtained; the costs involved in preparing, filing, obtaining, maintaining, defending and enforcing patent claims; our strategy to develop, acquire or in-license new technologies and products and other factors not within our control.

In July 2006 we were advised that the building in which our Vancouver office and lab operations are located is to be demolished in 2007 and we should plan to vacate our premises by March 31, 2007. Subsequent discussions indicate this date could be extended, however we have no confirmation of this. We are currently evaluating our options and have initiated a search for new premises in the Vancouver area. At this time we do not know the financial or operational implications of having to move our Vancouver operations. If we are unable to locate suitable replacement premises on a timely basis and/or make alternative arrangements, portions of our operations may be interrupted.

CONSOLIDATED BALANCE SHEETS

As at	July 31, 2006	April 30, 2006
(Unaudited—in thousands of Canadian dollars)	\$	\$
ASSETS		
Current		
Cash and cash equivalents	8,949	5,743
Short-term investments	5,020	3,642
Amounts receivable	111	108
Government assistance receivable	105	236
Prepaid expenses and deposits	293	362
Total current assets	14,478	10,091
Long-term investments	1	1
Other assets (note 2)	-	275
Equipment (note 3)	916	936
Intangible assets (note 3)	5,396	5,569
	20,791	16,872
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities (note 4)	2,036	3,828
Current portion of capital lease obligation	-	5
Total current liabilities	2,036	3,833
Convertible Royalty Participation Units (note 2)	3,249	-
Preferred shares (note 5[a][iii])	-	-
Total liabilities	5,285	3,833
Shareholders' equity		
Common shares (note 5[a][i])	117,684	117,666
Equity portion of Convertible Royalty Participation Units (note 2)	4,557	-
Contributed surplus (note 5[a][ii])	4,416	4,038
Deficit	(111,151)	(108,665)
Total shareholders' equity	15,506	13,039
	20,791	16,872

See accompanying notes

On behalf of the Board:

"Alistair Duncan"

Director

"Colin Mallet"

Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

(Unaudited—in thousands of Canadian dollars except per share amounts)	Three months ended July 31,	
	2006 \$	2005 \$
REVENUE		
Research and development collaboration (note 3)	-	269
	-	269
EXPENSES		
Research and development	1,341	2,029
General and corporate	789	827
Amortization	226	247
	2,356	3,103
Operating loss for the period	(2,356)	(2,834)
Other (expense) income		
Accretion of Convertible Royalty Participation Units (note 2)	(300)	-
Interest income	144	80
Foreign exchange gain (loss)	26	(18)
	(130)	62
Loss for the period	(2,486)	(2,772)
Deficit, beginning of period	(108,665)	(97,315)
Deficit, end of period	(111,151)	(100,087)
Basic and diluted loss per common share (note 5[e])	(0.03)	(0.04)
Weighted average number of common shares outstanding (in thousands – note 5[e])		
	74,299	69,440

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended July 31,	
(Unaudited—in thousands of Canadian dollars)	2006 \$	2005 \$
OPERATING ACTIVITIES		
Loss for the period	(2,486)	(2,772)
Items not affecting cash:		
Amortization	226	247
Stock-based compensation	147	105
Accretion of Convertible Royalty Participation Units (note 2)	300	-
Changes in non-cash working capital items relating to operating activities:		
Accrued interest on short-term investments	(13)	54
Amounts receivable	(3)	79
Government assistance receivable	131	453
Prepaid expenses and deposits	69	476
Accounts payable and accrued liabilities	(1,479)	(326)
Cash (used in) operating activities	(3,108)	(1,684)
FINANCING ACTIVITIES		
Issuance of Convertible Royalty Participation Units (note 2)	7,737	-
Issuance of common shares, net of issue costs	-	5,743
Proceeds on exercise of stock options	1	-
Proceeds on exercise of warrants	17	-
Repayment of capital lease obligation	(5)	(16)
Cash provided by financing activities	7,750	5,727
INVESTING ACTIVITIES		
Funds from short-term investments	2,897	5,958
Purchase of short-term investments	(4,261)	(5,397)
Purchase of equipment	(72)	(26)
Cash (used in) provided by investing activities	(1,436)	535
Increase in cash and cash equivalents	3,206	4,578
Cash and cash equivalents, beginning of period	5,743	1,181
Cash and cash equivalents, end of period	8,949	5,759

See accompanying notes

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (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 for interim financial statements. The accounting policies used in the preparation of these unaudited interim consolidated financial statements are consistent with the Company's most recent annual audited consolidated financial statements for the year ended April 30, 2006 with the exception of the adoption of the accounting policy for the convertible royalty participation units as described in note 2. These unaudited interim consolidated 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.

In the opinion of management, all adjustments (including reclassification and normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows have been made. Interim results are not necessarily indicative of results for a full year.

2. CONVERTIBLE ROYALTY PARTICIPATION UNITS

On May 3, 2006, the Company completed a financing of \$8,840,000 relating to a portion of the future royalties from the Company's license agreements with Cadence Pharmaceuticals and Cutanea Life Sciences. A total of 29,465 convertible royalty participation units were issued at a price of \$300 per unit. Each unit entitles the purchaser to receive up to \$1,000 of royalties under the license agreements to May 3, 2021. The \$1,000 of royalties per unit is as follows: [i] 75% of the royalties under the license agreements until \$300 of royalties is paid per unit; [ii] thereafter 50% of the royalties until a further \$300 of royalties is paid per unit; and [iii] thereafter 25% of the royalties received until a further \$400 of royalties is paid per unit. In the event there are no royalties under the license agreements there is no obligation for the Company to make any payments to the unit holders.

The units can be converted at any time, at the option of the holder, into the Company's common shares (initially 600 common shares per unit based on conversion price of \$0.50 per common share, with the number of common shares reduced proportionately for royalties received by the unit holders). Additionally, the Company has an option to convert the units into common shares exercisable if the 20 trading day weighted average closing price of the Company's common shares is \$2.00 or greater and the average daily trading volume is 30,000 or greater.

The Company's obligation to pay royalties from the license agreements and/or to issue common shares upon conversion of a unit terminates upon the earlier of: (i) the date \$1,000 of royalties has been paid in respect of the unit; (ii) the date the unit is converted into common shares; and (iii) May 3, 2021.

The Company has provided the purchasers (through a trustee) with a first-lien security interest over certain assets of the Company relating to the license agreements. The security interest can be acted on in the event of default by the Company including bankruptcy, non-payment of royalties received under the two license agreements, and certain other events. In the event of default the Company would become obligated to pay the unit holders \$1,000 per unit less the royalties paid in respect of the unit.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

2. CONVERTIBLE ROYALTY PARTICIPATION UNITS (continued)

In connection with completing the transaction, the Company: [i] paid the agent a cash commission of approximately \$707,000 and issued to the agent, warrants for the purchase of 883,950 common shares at a price of \$0.50 per common share, expiring May 3, 2009 (note 5[d][iii]); and [ii] incurred approximately \$396,000 in legal, professional and other costs of which approximately \$275,000 was included in other assets at April 30, 2006. The warrants issued to the agents were determined to have a value of approximately \$231,000 using the Black-Scholes option pricing model and have been recorded as contributed surplus (note 5[a][iii]).

The \$7,506,000 of net proceeds on issuance of the convertible royalty participation units has been classified in the Company's financial statements according to the separate equity and debt component parts using the relative fair value method resulting in: (1) \$4,557,000 being allocated to Equity portion of Convertible Royalty Participation Units representing the pro-rata fair value of the conversion feature as determined by the Black-Scholes option pricing model and (2) \$2,949,000 being allocated to the carrying value of the Convertible Royalty Participation Units. The aggregate fair value of the fees relating to the transaction of \$1,334,000 (inclusive of the fair value of the agents' warrants) have been offset against the Equity portion of Convertible Royalty Participation Units and the carrying value of the Convertible Royalty Participation Units on the same pro-rata basis used to allocate the original gross proceeds. The \$2,949,000 initial carrying value of the Convertible Royalty Participation Units will be accreted to the maximum royalties payable of \$29,465,000 (reduced for actual royalties paid and any units converted into common shares) over the estimated royalty payment term using the effective interest method with the corresponding accretion expense being included in the statement of loss. For the three months ended July 31, 2006, the accretion of the Convertible Royalty Participation Units amounted to \$300,000. Upon conversion of any of the convertible royalty participation units into common shares, the carrying value of the equity component plus the carrying value of the debt component would be reclassified as common share capital.

3. SEGMENTED INFORMATION

The Company operates primarily in one business segment with operations located in Canada and the United States. All of the Company's long-lived assets are located in Canada except for intellectual property and equipment with a net book value of \$4,636,000 (April 30, 2006 - \$4,779,000) and \$12,000 (April 30, 2006 - \$12,000), respectively, which are located in the United States. During the three months ended July 31, 2005, 100% of revenue was derived from one licensee in the United States.

4. RELATED PARTY TRANSACTIONS

All transactions with related parties are recorded at their exchange amounts and accounts payable are subject to normal trade terms. During the three months ended July 31, 2006, the Company incurred legal fees of approximately \$113,000 (\$128,000 for the three months ended July 31, 2005) inclusive of sales taxes, payable to a law firm where the Secretary of the Company is a partner. Included in accounts payable and accrued liabilities at July 31, 2006, is approximately \$240,000 (April 30, 2006 - \$349,000) owed to this law firm.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

5. SHARE CAPITAL

[a] Issued and outstanding

[i] Common shares

	Number of Shares (000's)	Amount \$ (000's)
Balance, April 30, 2006	74,259	117,666
Exercise of stock options	4	1
Exercise of warrants	36	17
Balance, July 31, 2006	74,299	117,684

[ii] Contributed surplus

	Amount \$ (000's)
Balance, April 30, 2006	4,038
Fair value of agents' warrants issued in connection with Convertible Royalty Participation Units (note 2)	231
Stock-based compensation (note 5[c])	147
Balance, July 31, 2006	4,416

[iii] Preferred shares

	Number of Shares (000's)	Amount \$ (000's)
Series A	350	-
Series B	1,000	-
Series C	5,250	-
Series D	4,000	-
Series E	4,000	-
Balance, April 30, 2006 and July 31, 2006	14,600	-

The 14,600,000 preferred shares outstanding at July 31, 2006 and April 30, 2006 represent up to US\$14,600,000 in potential future milestone payments related to drug development programs and other assets acquired by the Company. Upon the achievement of any of the milestones, the applicable number of preferred shares are, at the Company's option, either convertible into common shares of the Company or redeemable for cash at US\$1 per preferred share. As the achievement of any of the milestones for the redemption or conversion of the preferred shares are uncertain, the preferred shares have been recorded at an aggregate value of US\$5.

The 14,600,000 preferred shares have been classified as a liability.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

5. SHARE CAPITAL (continued)

[b] Stock options

- [i] 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:

	Number of Common Shares (000's)	Weighted Average Exercise Price \$
Balance, April 30, 2006	4,053	1.12
Options granted	648	0.46
Options exercised	(4)	(0.38)
Options forfeited/expired	(89)	(1.14)
Balance, July 31, 2006	4,608	1.02

The stock options expire at various dates between August 17, 2006 and July 16, 2014.

The maximum number of common shares that can be issued as at July 31, 2006 under the 1996 and 2000 Option Plans inclusive of stock options outstanding at July 31, 2006 is 5,308,500 (April 30, 2006 – 5,331,125). See note 7 for new stock plan.

- [ii] The following table summarizes information about options outstanding with respect to both the 1996 and 2000 Stock Option Plans at July 31, 2006:

Range of Exercise Prices \$	Options Outstanding			Options Exercisable	
	Number Common Shares (000's)	Weighted Average Exercise Price \$	Weighted Average Remaining Contractual Life (years)	Number Common Shares (000's)	Weighted Average Exercise Price \$
0.38-0.55	1,539	0.44	5.4	695	0.44
0.56-0.80	293	0.77	2.8	276	0.77
0.81-1.07	1,275	0.94	3.1	1,050	0.91
1.08-1.59	1,180	1.53	2.2	1,136	1.54
1.60-2.30	238	1.85	2.5	238	1.85
2.31-3.40	27	2.76	1.1	27	2.76
3.41-5.37	21	4.74	1.4	21	4.74
5.38-6.21	35	5.73	1.6	35	5.73
	4,608	1.02	3.6	3,478	1.16

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

5. SHARE CAPITAL (continued)

[c] Stock-based compensation expense

The Company recorded stock-based compensation expense of \$147,000 for the three months ended July 31, 2006 (\$105,000 for the three months ended July 31, 2005) relating to stock options granted to executive officers, directors, and employees since May 1, 2003 and to consultants since May 1, 2002. This expense has been allocated on the same basis as cash compensation resulting in \$35,000 (2005 - \$48,000) being allocated to research and development and \$112,000 (2005 - \$57,000) being allocated to general and corporate for the three months ended July 31, 2006. The estimated fair value of the stock options granted was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three months ended July 31,	
	2006	2005
Annualized volatility	76.1%	76.2%
Risk-free interest rate	4.4%	3.5%
Expected life of options in years	5.6	5.0
Dividend yield	0.0%	0.0%

The weighted average fair value of stock options granted during the three months ended July 31, 2006 was \$0.30 (2005 – \$0.26). The estimated fair value of stock options is amortized to expense over the vesting period of the stock options.

The Black-Scholes pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly variable assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the Black-Scholes model does not necessarily provide a reliable single measure of the fair value of the Company's stock options.

Pro-forma disclosure is required to reflect the impact on the Company had it elected to adopt the fair value method of accounting for options granted to executive officers, directors and employees effective May 1, 2002. If the computed fair values of stock options granted May 1, 2002 to April 30, 2003 had been amortized to expense over their vesting periods, the loss and loss per common share would have been:

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

5. SHARE CAPITAL (continued)

[c] Stock-based compensation expense (continued)

(thousands, except per share amounts)	Three months ended July 31,	
	2006 \$	2005 \$
Loss for the period as reported	(2,486)	(2,772)
Compensation charge related to stock options granted to executive officers, directors and employees during the period May 1, 2002 to April 30, 2003	-	(22)
Proforma loss for the period	(2,486)	(2,794)
Proforma basic and diluted loss per common share	(0.03)	(0.04)

[d] Warrants

As at July 31, 2006, the Company had warrants outstanding for the purchase of 10,268,000 (April 30, 2006: 9,425,000) common shares as follows:

Number of Common Shares Issuable upon Exercise (000's)	Exercise Price(s) per Common Share	Expiry Date(s)
983 ⁽ⁱ⁾	\$3.00	December 3, 2007
1,056 ⁽ⁱⁱ⁾	\$0.45	May 31, 2008
7,220 ⁽ⁱⁱ⁾	\$0.55	May 31, 2008
884 ⁽ⁱⁱⁱ⁾	\$0.50	May 3, 2009
125 ^(iv)	US\$13.21 to US\$17.75	March 20, 2007 to June 22, 2011
10,268	Average = \$0.95 ^(v)	

[i] These warrants have an exercise feature allowing the warrant holders to elect to satisfy their obligation to pay the exercise price to the Company by accepting a lesser number of common shares.

[ii] These warrants were issued as part of the May 2005 public offering.

[iii] These warrants were issued to the agents as part of the royalty unit financing (note 2).

[iv] These warrants were assumed as part of the acquisition of MitoKor and if exercised and the maximum milestone payments associated with the Series E Preferred shares (note 5[a][iii]) are achieved could result in the payment to the warrant holders of US\$86,303 in milestone payments, payable at the Company's option, in cash and/or common shares.

[v] Weighted average exercise price using closing July 31, 2006 exchange rate of US\$1.00 equals \$1.1316.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

 Three months ended July 31, 2006 (Unaudited—Canadian dollars)

5. SHARE CAPITAL (continued)
[e] Loss per common share

(thousands, except per share amounts)	Three months ended July 31,	
	2006 \$	2005 \$
Numerator:		
Loss for the period	(2,486)	(2,772)
Denominator:		
Weighted average number of common shares outstanding including escrowed shares	74,299	70,627
Less: weighted average number of escrowed shares outstanding	-	(1,187)
Weighted average number of common shares outstanding	74,299	69,440
Basic and diluted loss per common share	(0.03)	(0.04)

6. MATERIAL TRANSFER AND LICENSE OPTION AGREEMENT WITH SCHERING CORPORATION

On July 13, 2005 the Company entered into a Material Transfer and License Option agreement with Schering Corporation ("Schering") related to celgosivir (MX-3253), the Company's first-in-class compound in phase II clinical development for the treatment of chronic Hepatitis C Virus (HCV) infections.

Under the terms of the agreement, at no cost to the Company, Schering has supplied PEGETRON™ and is providing certain technical and laboratory support and other services for the Company's current MX-3253 phase IIb non-responder combination study in chronic HCV patients. In addition, the agreement grants Schering limited periods of exclusivity for data review of clinical trial results and for the negotiation of a license agreement. For the three months ended July 31, 2006, the Company estimates that the value of the PEGETRON™ and lab testing services received by the Company to be approximately \$205,000 (\$nil for the three months ended July 31, 2005) and the Company has recorded this non-monetary consideration and expense at a net cost of \$nil in research and development expenses for the three months ended July 31, 2006.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three months ended July 31, 2006 (Unaudited—Canadian dollars)

7. SUBSEQUENT EVENTS

On September 12, 2006 shareholders of the Company approved a new stock option plan and a deferred share unit plan subject to receiving Toronto Stock Exchange approval.

[a] 2006 Incentive Stock Option Plan (“2006 Plan”)

Under the 2006 Plan all future option grants by the Company will be made under the 2006 Plan. Any common shares that become available for the grant of new options under the existing 1996 and 2000 option plans [note 5[b][i]] will be transferred to the 2006 Plan. In addition to transfers from the 1996 and 2000 plans a further 2,000,000 common shares have been reserved for the grant of new options under the 2006 Plan.

[b] Deferred Share Unit Plan (“DSU Plan”)

Under the DSU Plan 750,000 common shares have been reserved for the issuance of deferred share units. A deferred share unit represents a future right to receive one common share or its equivalent fair market value in cash at the time of the holder's retirement, death, or the holder otherwise ceasing to provide services to the Company.