



**SECOND QUARTER REPORT  
OCTOBER 31, 2001**



**M I C R O L O G I X**

## TO OUR SHAREHOLDERS:

This quarter was highlighted by completion of our US Phase II clinical trial of MBI 594AN for the treatment of acne and the release of positive preliminary results from that trial in November. This quarter was also my first on the job here at Micrologix. It has been a very busy time for the Micrologix team as we examined all aspects of our operations and began to determine the strategy that will build an outstanding company.

### POSITIVE RESULTS FROM MBI 594AN PHASE II TRIAL

On November 30th, we announced preliminary results from the MBI 594AN Phase II trial initiated in November 2000. The randomized, double-blind study enrolled 75 acne patients, with twice-daily dosing over a six-week period, using either one of two formulations of MBI 594AN (2.5% and 5%) or the product's alcohol-based vehicle alone ("placebo"). The trial was designed to provide an indication of efficacy and to assess safety and tolerability, without being powered for statistical significance. In summary, the data showed:

- 32% total acne reduction (inflammatory and non-inflammatory lesions combined) compared with 14 percent reduction for the placebo. This result was statistically significant, in spite of the small study size.
- 39% reduction in inflammatory acne counts compared with 21 percent for the placebo group.
- 25% reduction in non-inflammatory acne compared with only 10 percent for placebo treated subjects.
- 41% improvement in physician's assessment compared with 32% for the placebo group.
- No discernible dose response. The 2.5% treatment group performed equal or superior to the 5% treatment group.
- Safe & well tolerated. There were no serious drug-related adverse events. Dryness of the skin was reported as the most common side effect, which occurred in all groups.

These results provide solid evidence of the anti-acne properties of MBI 594AN. An important part of the development of any new drug candidate, from both regulatory and business perspectives, is proper dosing. This normally occurs in Phase II studies. Based on this fact, along with the data generated from the trial, the next clinical trial for MBI 594AN is expected to be an expanded Phase II study, which would include lower dose levels, a longer treatment period (12 weeks vs. 6 weeks) and a larger number of patients. The timing of the next trial will be established based upon consideration of issues such as product formulation, manufacturing and cost of goods. These issues are not insignificant and could impact on the development and commercial feasibility of MBI 594AN.

### MBI 226 PHASE III TRIAL UPDATE

In September 2000, Micrologix commenced a pivotal Phase III trial of MBI 226 for the prevention of catheter-related bloodstream infections. Approximately 750 subjects have been enrolled to date. There are 20 sites enrolling patients, with one site having reached full enrolment. Since beginning the trial the Company's plan has been to enroll between 1000 and 1500 patients. A determination of the final enrolment target is expected to be made by February 2002.

### STRATEGY

Since I started October 1st, two of my principal objectives have been to establish a clearer strategic direction and optimize our ability to execute.

After analyzing our strategic options, and with the opportunities available to us, an important component of our strategy will be to expand our product pipeline. This will include a more focused, systematic approach to evaluating and selecting product candidates from our internal research & development programs. The strategy will also include pursuing opportunities to bring in additional product candidates and technologies consistent with our expertise and overall growth plans.

Another component of our strategy will be to manage our clinical development processes with a view toward a more strategic, comprehensive, and prudent approach to product development. This means evaluating the entire process and making sure we have the optimal chances of success, while managing the company's risks and resources carefully.

Lastly, as mentioned in my CEO Message, an essential component of our success will be having the right people in the right positions and in the right environment. This will involve augmenting our expertise in areas such as research & development, regulatory affairs, and product development.

One thing to remember is that this strategy will not be completed overnight. It is a process, not an event, and therefore, although implementation will begin immediately, it will take many months to see significant results.

### COMMUNICATIONS

I mentioned in my CEO Message that one of my commitments would be to communicate regularly. To meet this commitment, we have implemented several initiatives to enhance information flow. The first was my Quarterly CEO Message which you should have received around the beginning of November. My next CEO Message should be in the mail by mid February. We also set up a CEO Mailbox on our website. This mailbox is for any questions or comments you may have about the company.

We held a conference call on November 30th to announce and discuss the results of our Phase II acne trial and held our first regular quarterly call on December 12th to announce the second quarter results and provide an update on the Company. Our goal is to get the Micrologix story out to as broad an audience as possible in a credible, compelling and consistent manner. We will continue to expand these efforts in the New Year.

I have enjoyed my first few months here at Micrologix and look forward to the exciting times ahead. Happy holidays from the entire Micrologix team. We thank you for your support.

Respectfully,

"JAMES M. DEMESA"

**JAMES M. DEMESA, MD**  
President and CEO, Director

December 12, 2001

# MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Second Quarter ended October 31, 2001

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

## OVERVIEW

Micrologix is a biotechnology company engaged in the research, development and commercialization of innovative drugs to treat or prevent infectious diseases. We currently have two drugs in clinical development: MBI 226 for preventing catheter-related bloodstream infections (Phase III) and MBI 594AN for treating acne (Phase II).

### MBI 226 — Prevention of Central Venous Catheter-Related Bloodstream Infections

At October 31, 2001 we had enrolled approximately 630 patients in the Phase III trial of MBI 226. Our plan has been to enroll between 1000 and 1500 patients in this study. The determination of the final enrollment target is expected to be made in February 2002 with results from the trial anticipated before the end of 2002.

Our intention, based on positive results from the current Phase III trial, is to submit a New Drug Application ("NDA") to obtain marketing approval for MBI 226 in the US. However, there are several other factors, such as securing a strategic partner and completion of manufacturing activities, that could impact either the timing of a NDA submission, its subsequent approval or our ability to market the product. We are investigating and refining our strategy to address these issues including completion of a more detailed analysis of the market and competitive environment.

Although there is interest from potential strategic partners, a deal for MBI 226 may not be feasible until after results from the current Phase III trial.

### MBI 594AN — Treatment of Acne

Based on the positive Phase II results and the need to determine proper dosing, the next clinical trial for MBI 594AN is anticipated to be an expanded Phase II study. The design and timing of this study is being investigated along with issues such as product formulation, manufacturing and cost of goods. These issues are not insignificant and could impact on the development and commercial feasibility of MBI 594AN. In addition, cost of goods is a significant factor in completing a strategic partnership for this drug candidate.

## RESULTS OF OPERATIONS

The net loss for the three months ended October 31, 2001 ("Q2/02") is \$4.6 million (\$0.12 per share) compared to a net loss of \$2.8 million (\$0.07 per share) for the same period in 2000 ("Q2/01"). The year to date six month net loss ("YTD Fiscal 2002") is \$9.2 million (\$0.24 per share) compared to \$4.6 million (\$0.12 per share) for the same period in 2000 ("YTD Fiscal 2001"). The increases in net loss result principally from costs associated with our clinical development programs (see "Research & Development Expenses").

Micrologix has been unprofitable since its formation in January 1993 and has incurred a cumulative deficit of \$50.5 million to October 31, 2001. Losses are expected to continue for the next several years as we pursue the research, development and commercialization of our drug candidates and technologies.

Second Quarter ended October 31, 2001

## Revenues

Interest income generated from investments of cash resources for Q2/02 was \$0.6 million (\$0.9 million in Q2/01) bringing YTD Fiscal 2002 interest income to \$1.3 million (\$1.7 million for same period in 2000). These decreases are the result of lower average cash balances available for investment (see "Liquidity and Capital Resources") and declining interest rates.

Micrologix currently has no revenues from product sales or licensing of products and/or technology to third parties. We anticipate that future revenues will consist primarily of licensing fees, research and development payments, milestone payments and royalties from licensing and collaborative agreements with pharmaceutical companies.

## Research and Development Expenses

Research and development expenses increased in Q2/02 to \$4.1 million (\$2.9 million in Q2/01) bringing YTD Fiscal 2002 research and development expenses to \$8.5 million (\$4.8 million YTD Fiscal 2001). The increase in research and development expenses results principally from our clinical development programs including the MBI 226 Phase III clinical trial initiated in Q2/01 and related activities. Clinical development program costs were \$3.0 million in Q2/02 (\$2.0 million in Q2/01) bringing YTD Fiscal 2002 clinical development program costs to \$6.3 million (\$3.0 million in YTD Fiscal 2001).

The level of research and development expenses for the remainder of Fiscal 2002 will be impacted principally by enrolment in the MBI 226 Phase III trial and activities related to the MBI 594AN program.

## General and Corporate Expenses

General and corporate expenses for Q2/02 were \$1.1 million (\$0.8 million in Q2/01) bringing YTD Fiscal 2002 general and corporate expenses to \$2.0 million (\$1.4 million YTD Fiscal 2001). This increase is spread across many expense categories and can be generally attributed to a greater level of activity associated with our clinical development programs.

## CAPITAL EXPENDITURES

Expenditures in Q2/02 for capital and intangible assets were \$0.2 million bringing total for YTD Fiscal 2002 to \$0.4 million.

## LIQUIDITY AND CAPITAL RESOURCES

At October 31, 2001, we had \$47.9 million (April 30, 2001: \$55.8 million) in cash, cash equivalents and short-term investments. At October 31, 2001 \$47.0 million of these funds were invested in high-grade liquid short-term investments (investments with maturity date at time of purchase greater than three months) with interest rates ranging from 3.3% to 6.5% and maturities ranging from Nov/01 to Dec/03.

The decrease in cash, cash equivalents and short-term investments since April 30, 2001 is mainly attributable to the net loss for YTD Fiscal 2002. 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

	October 31, 2001	April 30, 2001
(Unaudited—in thousands of Canadian dollars)	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	915	9,953
Short-term investments	47,038	45,839
Amounts receivable	64	148
Prepaid expenses and deposits	479	258
<b>Total current assets</b>	<b>48,496</b>	<b>56,198</b>
Capital assets	1,534	1,599
Intangible assets	1,853	1,752
	<b>51,883</b>	<b>59,549</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	5,913	4,523
<b>Total current liabilities</b>	<b>5,913</b>	<b>4,523</b>
Contingencies (note 3)		
<b>Shareholders' equity</b>		
Share capital (note 2)	96,358	95,722
Shares to be issued	111	613
Deficit	(50,499)	(41,309)
<b>Total shareholders' equity</b>	<b>45,970</b>	<b>55,026</b>
	<b>51,883</b>	<b>59,549</b>

See accompanying notes

On behalf of the Board:

“COLIN R. MALLET”

“JAMES M. DEMESA”

**COLIN R. MALLET**

Director

**JAMES M. DEMESA**

Director

## CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

	Three months ended October 31		Six months ended October 31	
(Unaudited—in thousands of Canadian dollars except per share amounts)	2001	2000	2001	2000
	\$	\$	\$	\$
<b>REVENUE</b>				
Interest income	597	873	1,263	1,663
<b>EXPENSES</b>				
Research and development	4,099	2,903	8,470	4,780
General and corporate	1,075	782	1,983	1,448
	5,174	3,685	10,453	6,228
<b>Loss for the period</b>	<b>(4,577)</b>	<b>(2,812)</b>	<b>(9,190)</b>	<b>(4,565)</b>
Deficit, beginning of period	(45,922)	(31,353)	(41,309)	(29,600)
<b>Deficit, end of period</b>	<b>(50,499)</b>	<b>(34,165)</b>	<b>(50,499)</b>	<b>(34,165)</b>
<b>Loss per common share</b>				
(note 2(c))	(0.12)	(0.07)	(0.24)	(0.12)
<b>Weighted average number of common shares outstanding</b>				
(in thousands) (note 2(c))	38,287	38,135	38,237	36,330

See accompanying notes

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended October 31		Six months ended October 31	
	2001	2000	2001	2000
(Unaudited—in thousands of Canadian dollars)	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Loss for the period	(4,577)	(2,812)	(9,190)	(4,565)
Items not affecting cash:				
Amortization	167	135	330	253
Write-down of capitalized patent costs	—	—	40	—
Loss on disposal of capital assets	27	—	47	—
Changes in non-cash working capital items relating to operating activities:				
Accrued interest on short-term investments	(98)	(289)	(220)	(425)
Amounts receivable	25	(95)	84	(99)
Prepaid expenses and deposits	(196)	(257)	(221)	(262)
Accounts payable and accrued liabilities	(32)	782	1,406	647
<b>Cash flows used in operating activities</b>	<b>(4,684)</b>	<b>(2,536)</b>	<b>(7,724)</b>	<b>(4,451)</b>
<b>FINANCING ACTIVITIES</b>				
Issuance of common shares, net of issue costs	—	8,693	49	9,328
Issuance of special warrants, net of issue costs	—	(55)	(19)	(201)
<b>Cash flows provided by financing activities</b>	<b>—</b>	<b>8,638</b>	<b>30</b>	<b>9,127</b>
<b>INVESTING ACTIVITIES</b>				
Funds from (purchase of) short-term investments	560	(23,324)	(979)	(23,437)
Purchase of capital assets	(120)	(287)	(241)	(329)
Intangible asset expenditures	(49)	(213)	(124)	(549)
<b>Cash flows provided by (used in) investing activities</b>	<b>391</b>	<b>(23,824)</b>	<b>(1,344)</b>	<b>(24,315)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(4,293)</b>	<b>(17,722)</b>	<b>(9,038)</b>	<b>(19,639)</b>
Cash and cash equivalents, beginning of period	5,208	43,098	9,953	45,015
<b>Cash and cash equivalents, end of period</b>	<b>915</b>	<b>25,376</b>	<b>915</b>	<b>25,376</b>
<b>Supplemental cash flow information</b>				
Increase in intangible assets for common shares to be issued	—	—	85	503

See accompanying notes

## NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Six months ended October 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.

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. SHARE CAPITAL

#### [a] Issued and outstanding

	Number of Common Shares (thousands)	Amount \$ (thousands)
<b>Balance, April 30, 2001</b>	39,359	95,722
Issued for cash pursuant to:		
Exercise of stock options	15	49
Issued pursuant to license and development agreement	100	587
<b>Balance, October 31, 2001</b>	<b>39,474</b>	<b>96,358</b>

#### [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:

	Number of Common Shares (thousands)	Weighted Average Exercise Price \$
<b>Balance, April 30, 2001</b>	1,702	3.97
Options granted	1,149	1.63
Options exercised	(15)	3.30
Options forfeited/expired	(948)	(3.54)
<b>Balance, October 31, 2001</b>	<b>1,888</b>	<b>2.77</b>

The stock options expire at various dates between October 25, 2002 and September 6, 2010.

## NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS, CONTINUED

Six months ended October 31, 2001 (Unaudited—Canadian dollars)

### [c] Loss per common share

Effective February 1, 2001, the Company retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants Section 3500 ("Earnings per Share") with respect to the calculation of loss per common share. This change had no impact on the loss per common share previously reported for the period ended October 31, 2000.

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.

**MICROLOGIX BIOTECH INC. is a biotechnology company engaged in the research, development and commercialization of innovative drugs to treat or prevent infectious diseases. The Company's current portfolio of anti-infective drug candidates is based on improved analogs of naturally occurring cationic peptides found in the host defense systems of most life forms. Micrologix currently has two drugs in clinical development: MBI 226 for preventing catheter-related bloodstream infections (Phase III) and MBI 594AN for treating acne (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.



# MICROLOGIX

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