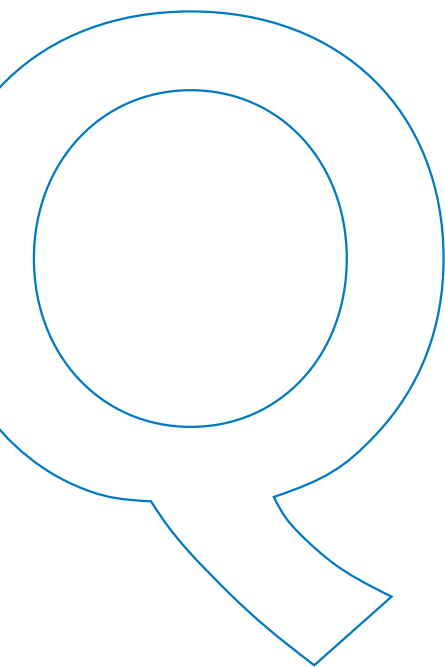




MICROLOGIX

(January 31, 2003)



3

**Micrologix
Third Quarter
Report**

MICROLOGIX BIOTECH INC.

is engaged in the research, development, and commercialization of drugs that advance therapy, improve health, and enrich lives. The Company's focus is toward anti-infective drug development with three product candidates in human clinical studies, multiple product opportunities in development, and several early-stage technologies in various stages of research and evaluation.

Forward-looking Statements

This Quarterly Report, including the discussion "From The Micrologix Team" 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 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: 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. These and other factors are described in detail in the Company's Annual Information Form and Annual Report on Form 20-F, forthcoming Quarterly Reports 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 Micrologix is not obligated to update such information to reflect later events or developments.

FROM THE MICROLOGIX TEAM

In calendar year 2002, we focused on building a solid foundation for Micrologix by concentrating mainly on *People, Pipeline, and Partnerships*. Most agree we were extremely successful in meeting our objectives in those areas, transforming our organization into a leader in anti-infective drug development with an experienced team, a robust pipeline, and a solid commercial partner for our lead program. This calendar year, we're focused mainly on *Capital, Clinicals and Critical Mass* and we are well on our way to achieving similar success.

CAPITAL

As you'll see in our financial statements that follow, we still have about two years of cash on hand at our current burn rate. Even though we've more than tripled our technologies and product opportunities over the past year, our burn rate today is lower than it was a year ago. A big part of that reduction in burn rate is due to our very successful partnership with Fujisawa Healthcare, Inc. On top of that, another strategy we are implementing to further leverage our resources is by collaborating with other companies on early stage projects. We are achieving this on two projects, with large pharmaceutical companies using their resources to advance our programs. In addition, we are relentless at managing expenses and are exploring several non-dilutive funding opportunities.

CLINICALS

At the beginning of February, we announced completion of enrollment in the MBI 226 Phase III study for the prevention of central venous catheter-related bloodstream infections with over 1400 patients enrolled. We expect results during the third quarter of this calendar year, and if positive, a New Drug Application could be filed with the U.S. FDA in the first half of 2004.

In January, we announced the start of our MBI 594AN Phase IIb acne study. We expect results of this trial in the fourth quarter of this calendar year, and since this program is now advancing into late-stage clinical development, our objective is to partner this product similar to MBI 226 (assisting us further with our focus on extending our *capital* resources). We have seen significant interest in this product from multiple potential partners.

Although not technically a clinical candidate, the Hepatitis C Virus (HCV) Replication Assay represents potential near-term revenue. Earlier this year, work on the HCV assay was initiated by two external parties (partially utilizing their own resources). If the initial evaluation is positive, the assay could be validated prior to the end of this calendar year. If validated, non-exclusive out-licensing is possible in calendar 2004.

MBI 1121 is our newest clinical candidate, brought in as part of our anti-viral portfolio acquisition in September 2002. This topical, antisense oligonucleotide is for the treatment of genital warts associated with Human Papillomavirus (HPV). We are currently managing specific manufacturing, formulation, and market considerations prior to committing the resources required for further clinical and/or non-clinical activity in this program.

CRITICAL MASS

We expect our growing pipeline to form the basis for future product candidates. Our objective is to continuously prioritize our programs and continue building a pipeline that can generate multiple commercial opportunities. In this regard, these are our current highest priority earlier stage programs:

- **Lipopeptide (anti-bacterial):** Lead candidate identification continues. Formal non-clinical studies are expected to be initiated in the first half 2004.
- **Nucleic Acid Mimics (anti-viral):** Lead identification was begun on the Hepatitis B Virus (HBV) and HCV technologies.

This year is a big year for Micrologix. Maintaining strong *capital* resources will enable us to advance our business most effectively. *Clinical* success on our two latest-stage programs is expected to provide the continued momentum we need to meet our short-term objectives and longer-term strategic goals. And, continued expansion of our pipeline will help *critical mass* for the future.

On behalf of the entire team, your support is greatly appreciated.

"JIM DEMESA, MD"

JIM DEMESA, MD
March 21, 2003
President and CEO

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

Third Quarter ended January 31, 2003

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, 2002; and the interim unaudited consolidated financial statements for the period ended January 31, 2003, including the related notes therein.

OVERVIEW

MBI 226—Prevention of Central Venous Catheter-Related Bloodstream Infections (CVC BSI's)

In July 2002, Micrologix completed a Collaboration and License Agreement with Fujisawa Healthcare Inc. ("Fujisawa") for the co-development and commercialization of MBI 226. Terms of the agreement include:

- Micrologix received US\$1 million as an upfront license fee and can receive up to US\$20 million in future milestone payments, as well as a royalty of 20% on net sales of MBI 226.
- Fujisawa funds 100% of the MBI 226 development costs commencing May 2002 and is responsible for manufacturing.
- Fujisawa has exclusive rights to market and sell the product in the US, Canada, and Mexico.
- Formation of a joint development management committee ("JDMC") with representation from both organizations to oversee and guide the future development of MBI 226.

Patient enrolment in the Phase III study was completed in January 2003 with over 1,400 patients enrolled. The last patient completed the study in February 2003 and results from the trial are anticipated to be available in the third calendar quarter of 2003. Normally two pivotal Phase III studies are required as part of a New Drug Application ("NDA") to obtain marketing approval in the United States for a new drug. Based on having received fast-track designation from the United States Food and Drug Administration for MBI 226, Micrologix and Fujisawa are pursuing a strategy to file a NDA based on one pivotal Phase III study. The filing of the NDA is dependent upon a number of factors, including, but not limited to, positive (statistically significant superiority of MBI 226 as compared to the standard of care) results from the Phase III study; successful completion of the validation and scale up of drug product manufacturing operations currently underway; decisions of the JDMC; and discussions with the FDA preceding the NDA submission. Micrologix and Fujisawa are targeting to submit the NDA in the first half of calendar 2004.

MBI 594AN—Treatment of Acne

Enrollment in a Phase IIb clinical trial for MBI 594AN was initiated in January 2003. This study includes a planned enrollment of 240 patients in 9 US centers, and is randomized (double-blinded) for patients to receive either a 2.5% MBI 594AN solution, a 1.25% MBI 594AN solution, or the vehicle (placebo) alone, for 12 weeks. The study is designed with the target of obtaining a statistically significant reduction in inflammatory lesions. Completion and results from the study are anticipated in the fourth calendar quarter of 2003. The Company is actively pursuing a co-development and commercialization license for MBI 594AN to potential pharmaceutical partners as was done with MBI 226 earlier in the year in order to meet the objective of advancing this program in the best, quickest way possible while managing cash resources. Although we are currently in various stages of discussion with potential partners, the timing for completing a license agreement for this program is not clear as the Company and/or the potential partners may decide to wait until after the Phase IIb results, which would mean licensing in the first half of calendar 2004 or later (if at all). In the absence of a license agreement the Company may choose to delay certain development spending pending the results of the Phase IIb trial and/or other events.

Third Quarter ended January 31, 2003

Building the Product Pipeline

During the first nine months of fiscal 2003 Micrologix has expanded its technology base and broadened the number of product candidates being pursued:

- In May 2002, the Company acquired two preclinical anti-infective programs, a lipopeptide and a polyene (see Note 3a to the financial statements). Both technologies comprise multiple compounds in the lead identification stage of development, and are intended to target serious systemic bacterial and systemic fungal infections, respectively.
- In September 2002, pursuant to a Call for Tenders in the bankruptcy of Origenix Technologies Inc ("Origenix"), the Company acquired a broad portfolio of antiviral technologies and product candidates (see Note 3b to the financial statements). The portfolio includes:
 - An anti-sense oligonucleotide topical drug candidate (MBI 1121), for the treatment of diseases associated with *Human Papillomavirus* (HPV) such as external genital warts. A Phase I clinical study to evaluate safety in 30 human volunteers was completed in late 2001 by Origenix. In conjunction with this program, we entered into a collaboration and license agreement with Hybridon, Inc.
 - A portfolio of therapeutic programs based on a proprietary, novel nucleic acid mimic technology (Hepatitis B Virus (HBV) program in the lead optimization stage of development; Hepatitis C Virus (HCV) program in early lead optimization; Human Immunodeficiency Virus (HIV) program comprised of a library of potential compounds).
 - A HCV assay technology under development as a novel, cell-based viral replication assay. This assay has the potential for broad appeal to companies seeking to develop anti-HCV drugs.

A review of the above programs was recently completed as part of the process of establishing development plans for same and allocating resources. The lipopeptide program will continue with the objective being to identify a lead candidate by the end of calendar 2003 and to initiate non-clinical studies in the first half of calendar 2004. Evaluation of the HCV assay technology has commenced and if this evaluation is positive, validation of the assay is planned to be completed by the end of calendar 2003 and, if validated, out-licensing could begin in 2004. Lead identification work has commenced in the HBV and HCV nucleic acid programs to generate additional data and advance the programs. Activities for the MBI 1121 HPV program over the next 6 to 9 months will be focussed on addressing specific manufacturing, formulation, and market considerations prior to further clinical and/or non-clinical development. Regarding the polyene technology, a plan is being developed to out-license the program. Some augmentation and restructuring of our research and development personnel has occurred and further restructuring may occur to support the development programs.

RESULTS OF OPERATIONS

The net loss for the three months ended January 31, 2003 ("Q3/03") is \$4.0 million (\$0.09 per share) compared with a net loss of \$4.9 million (\$0.13 per share) for the same period in fiscal 2002 ("Q3/02"). The year to date nine month net loss ("YTD Fiscal 2003") is \$7.9 million (\$0.20 per share) compared with a net loss of \$14.1 million (\$0.37 per share) for the same period in 2002 ("YTD Fiscal 2002"). The decrease in net loss results principally from revenues associated with the Collaboration and License agreement entered into with Fujisawa for MBI 226 (see "Revenues") and a reduction in research and development costs (see "Research & Development Expenses").

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

Third Quarter ended January 31, 2003

The anticipated quarterly losses for the remainder of Fiscal 2003 and Fiscal 2004 are not expected to increase significantly beyond the Q3/03 level, however this will be impacted principally by results from the MBI 226 Phase III trial (see "MBI 226—Prevention of CVC—BSI's"), the MBI 594AN Phase IIb trial and the licensing status of MBI 594AN (currently not licensed—see "MBI 594AN—Treatment of Acne") and the advancement of other development programs (see "Building the Product Pipeline").

Effective May 1, 2002, Micrologix adopted the recommendations of the new CICA handbook section 3870, Stock Based Compensation and other Stock-Based Payments (see Notes 2 and 4 [b] [ii] to the financial statements).

Micrologix has been unprofitable since its formation in January 1993 and has incurred a cumulative deficit of \$69.2 million to January 31, 2003. Losses are expected to continue for the next several years as we pursue the research, development and commercialization of our drug candidates and technologies.

Revenues

In July 2002, the Company entered into a Collaboration and License agreement with Fujisawa for MBI 226 (see "MBI 226—Prevention of CVC BSI's") and received a non-refundable upfront license fee of US\$1 million. This fee is being amortized into income over the estimated development period (approximately three and one-half years) for MBI 226 in the United States, Canada and Mexico (\$0.1 million in Q3/03; \$0.3 million YTD Fiscal 2003) with the unamortized portion being recorded as deferred revenue on the balance sheet. During YTD Fiscal 2003, the Company has recorded \$6.5 million (\$nil in YTD Fiscal 2002) in research and development collaboration revenue pursuant to the collaboration with Fujisawa. See Note 2 to the financial statements for the Company's Revenue Recognition policy which was adopted during Q1/03.

Interest income generated from investments of cash resources for Q3/03 was \$0.2 million (\$0.5 million in Q3/02) bringing YTD Fiscal 2003 interest income to \$0.8 million (\$1.8 million for YTD Fiscal 2002). The decrease is the result of lower average cash balances available for investment (see "Liquidity and Capital Resources") and declining interest rates.

Research and Development Expenses

Research and development expenses for Q3/03 were \$5.5 million (\$4.4 million in Q3/02) bringing YTD Fiscal 2003 research and development expenses to \$11.7 million (\$12.5 million for YTD Fiscal 2002). Clinical development program costs were \$4.2 million of research and development expenses in Q3/03 (\$3.7 million in Q3/02) bringing YTD Fiscal 2003 clinical development program costs to \$8.6 million (\$10.0 million for YTD Fiscal 2002).

General and Corporate Expenses

General and corporate expenses for Q3/03 were \$1.2 million (\$0.8 million in Q3/02) bringing YTD Fiscal 2003 general and corporate expenses to \$3.3 million (\$2.7 million for YTD Fiscal 2002).

CAPITAL AND INTANGIBLE ASSET EXPENDITURES

YTD Fiscal 2003 expenditures for capital and intangible assets are \$3.2 million (\$0.6 million for YTD Fiscal 2002). The major components of capital and intangible asset expenditures were for the acquisition of the Origenix antiviral programs, the Hybridon license for the MBI 1121 HPV program and the acquisition of the lipopeptide and polyene programs—these expenditures total \$2.6 million. See "Building Our Product Pipeline", Notes 3, 4 [a] [ii], [iii] and [iv] to the financial statements and "Liquidity and Capital Resources" below for additional information in respect of these acquisitions.

Third Quarter ended January 31, 2003

LIQUIDITY AND CAPITAL RESOURCES

At January 31, 2003, the Company had \$30.3 million (April 30, 2002: \$39.9 million) in cash, cash equivalents and short-term investments. At January 31, 2003, \$23.2 million of these funds were invested in high-grade liquid short-term investments with interest rates ranging from 2.7% to 5.0% and maturities ranging from February 18, 2003 to November 15, 2004. The \$9.6 million decrease in cash, cash equivalents and short-term investments since April 30, 2002 consists primarily of the \$7.9 million net loss for YTD Fiscal 2003, \$2.1 million in asset acquisitions (cash component), \$3.0 million decrease in accounts payable and accrued liabilities, \$3.4 million increase in amounts receivable (research and collaboration development revenue is billed quarterly to Fujisawa—see "Revenues"), and \$0.6 million paid on redemption of 400,000 Series A preferred shares, less \$5.5 million in proceeds from equity financing completed in December and \$1.3 million of deferred revenue related to the upfront MBI 226 license fee (see "Revenues").

On December 3, 2002 the Company issued 7,850,000 common shares for gross proceeds of \$5.5 million. Additionally, the Company issued warrants to purchase (i) 987,500 common shares at \$1.50 per common share; and (ii) 982,914 common shares at \$3.00 per common share. These warrants, subject to certain earlier expiry provisions, expire December 5, 2005 and December 3, 2007, respectively.

During Fiscal 2003 the Company has issued 750,000 Series A preferred shares, 1,000,000 Series B preferred shares and 5,500,000 Series C preferred shares in conjunction with the acquisition/licensing of the lipopeptide, polyene and HPV programs (see also "Building the Product Pipeline", "Capital and Intangible Asset Expenditures", Notes 3, 4 [a] [ii], [iii] and [iv] to the financial statements for additional information). The Series A, B and C 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. In Q2/03 the Company redeemed 400,000 Series A preferred shares by paying US\$400,000 and is required to redeem or convert 250,000 of the Series C preferred shares in April 2003. The remaining 350,000 Series A shares, 1,000,000 Series B shares and 5,250,000 of the Series C preferred shares are to be redeemed or converted from time to time upon the achievement of specified drug development milestones in the lipopeptide, polyene and HPV programs. The Company is also obligated in the future to pay:

- i. up to US\$3 million cash if certain drug development milestones are achieved; and
- ii. royalties on product sales.

There are currently 47,372,159 common shares and 6,850,000 preferred shares issued and outstanding.

Micrologix believes that its funds on hand at January 31, 2003, together with amounts receivable, reimbursement of development costs and expected interest income, should be sufficient to finance its operating and capital needs for approximately the next 2 years without reflecting the receipt of potential MBI 226 milestone payments in the amount of US\$15 million during this period or cash flow that may result from additional out-licensing activities (see "MBI 594AN—Treatment of Acne" and "Building the Product Pipeline"). Micrologix's funding needs will vary, however, depending upon a number of factors including the breadth and progress of the Company's research and development programs and future decisions in respect thereof, the costs associated with clinical studies and the regulatory process, collaborative and licensing arrangements with third parties, opportunities to in-license or acquire additional products and/or technologies for development, the possibility of unanticipated costs and expenses, technological and market developments and the costs of obtaining and enforcing patent claims. In the future, Micrologix will need to raise additional funds in support of its operations.

CONSOLIDATED BALANCE SHEETS

As at	January 31, 2003	April 30, 2002
(Unaudited—in thousands of Canadian dollars)	\$	\$
ASSETS		
Current		
Cash and cash equivalents	7,085	4,607
Short-term investments	23,172	35,281
Amounts receivable	3,463	84
Prepaid expenses and deposits	471	508
Total current assets	34,191	40,480
Capital assets	1,361	1,556
Intangible assets (note 3)	3,605	720
	39,157	42,756
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	4,627	7,507
Deferred revenue	448	—
Total current liabilities	5,075	7,507
Deferred revenue, non-current portion	819	—
Shareholders' equity		
Common shares (note 4(a))	101,896	96,358
Preferred shares (note 4(a))	397	—
Shares to be issued	111	111
Contributed surplus	23	—
Deficit	(69,164)	(61,220)
Total shareholders' equity	33,263	35,249
	39,157	42,756

See accompanying notes

On behalf of the Board:

“KENNETH H. GALBRAITH”

“COLIN R. MALLET”

KENNETH H. GALBRAITH
Director

COLIN R. MALLET
Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

(Unaudited—in thousands of Canadian dollars except per share amounts)	Three months ended January 31		Nine months ended January 31	
	2003 \$	2002 \$	2003 \$	2002 \$
REVENUE				
Licensing	115	—	257	—
Research and development collaboration	2,612	—	6,532	—
Interest	207	495	805	1,758
	2,934	495	7,594	1,758
EXPENSES				
Research and development	5,520	4,357	11,702	12,523
General and corporate	1,186	829	3,279	2,746
Amortization	200	176	557	506
Write-down of intangible assets	—	—	—	40
	6,906	5,362	15,538	15,815
Loss for the period	(3,972)	(4,867)	(7,944)	(14,057)
Deficit, beginning of period	(65,192)	(50,499)	(61,220)	(41,309)
Deficit, end of period	(69,164)	(55,366)	(69,164)	(55,366)
Basic and diluted loss per common share	(0.09)	(0.13)	(0.20)	(0.37)
Weighted average number of common shares outstanding (in thousands)	43,569	38,287	40,064	38,254

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended January 31		Nine months ended January 31	
	2003 \$	2002 \$	2003 \$	2002 \$
(Unaudited— in thousands of Canadian dollars)				
OPERATING ACTIVITIES				
Loss for the period	(3,972)	(4,867)	(7,944)	(14,057)
Items not affecting cash:				
Amortization	200	176	557	506
Stock based compensation	4	—	23	—
Write-down of intangible assets	—	—	—	40
(Gain) Loss on disposal of capital assets	(1)	—	(7)	47
Changes in non-cash working capital items relating to operating activities:				
Accrued interest on short-term investments	46	(20)	214	(240)
Amounts receivable	(924)	(13)	(3,379)	71
Prepaid expenses and deposits	190	(25)	37	(246)
Accounts payable and accrued liabilities	1,447	1,212	(2,972)	2,618
Deferred Revenue	(114)	—	1,267	—
Cash flows used in operating activities	(3,124)	(3,537)	(12,204)	(11,261)
FINANCING ACTIVITIES				
Issuance of common shares, net of issue costs	5,495	—	5,538	49
Issuance of special warrants, net of issue costs	—	—	—	(19)
Redemption of preferred shares	—	—	(619)	—
Cash flows provided by financing activities	5,495	—	4,919	30
INVESTING ACTIVITIES				
Funds from short-term investments	6,023	11,609	23,825	29,817
Purchase of short-term investments	(3,466)	(6,664)	(11,929)	(25,851)
Purchase of capital assets	(48)	(61)	(181)	(302)
Intangible asset expenditures	(178)	(126)	(1,965)	(250)
Proceeds on disposal of capital assets	—	—	13	—
Cash flows provided by investing activities	2,331	4,758	9,763	3,414
Increase (decrease) in cash and cash equivalents	4,702	1,221	2,478	(7,817)
Cash and cash equivalents, beginning of period	2,383	915	4,607	9,953
Cash and cash equivalents, end of period	7,085	2,136	7,085	2,136
Supplemental cash flow information				
Issuance of preferred shares in settlement of license fee payable in connection with acquisition of intangible assets (notes 3(b)(i) and 4(a)(iv))	397	—	397	—
Increase in intangible assets for preferred shares issued	—	—	619	—
Increase in intangible assets for common shares issued or to be issued	—	—	—	85

See accompanying notes

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Nine months ended January 31, 2003 (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 interim financial statements are consistent with the Company's most recent annual audited financial statements for the year ended April 30, 2002 except as disclosed in note 2. 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. CHANGES IN SIGNIFICANT ACCOUNTING POLICIES

The following new accounting principles have been adopted for the preparation of these consolidated interim financial statements:

Stock-based compensation plan

The Company has adopted the recommendations of the new CICA Handbook section 3870, *Stock-Based Compensation and Other Stock-Based Payments*, effective May 1, 2002. This section establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. The standard requires that all stock-based awards made to non-employees be measured and recognized using a fair value based method. The standard encourages the use of a fair value based method for all awards granted to employees, but only requires the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets. The Company has adopted the disclosure only provisions of section 3870 for stock options granted to employees and directors and consequently has disclosed the pro forma effects to net loss and net loss per share as if the fair value method had been used.

Revenue Recognition

Licensing revenue consists of non-refundable initial fees derived from collaborative licensing arrangements. Initial fees received which require the Company's ongoing involvement through development collaboration are deferred and amortized into income on a straight-line basis over the term of the underlying product development period.

Research and development collaboration revenues consist of non-refundable research and development funding under collaborative agreements with the Company's strategic partners. Research and development funding generally compensates the Company for non-clinical and clinical expenses related to the collaborative development programs for certain product candidates of the Company, and is recognized as revenue when the research and development activities are performed under the terms of the agreements.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS, CONTINUED

Nine months ended January 31, 2003 (Unaudited—Canadian dollars)

3. INTANGIBLE ASSETS

	Cost \$ (thousands)	Accumulated Amortization \$ (thousands)	Net Book Value \$ (thousands)
January 31, 2003			
Patents	1,249	327	922
Technology licenses	3,283	623	2,660
Trademarks	27	4	23
	4,559	954	3,605
April 30, 2002			
Patents	813	253	560
Technology licenses	609	473	136
Trademarks	26	2	24
	1,448	728	720

- [a] On May 20, 2002, the Company acquired certain intangible assets related to two pre-clinical programs (lipopeptide and polyene) from IntraBiotics Pharmaceuticals, Inc. and entered into a license and research agreement with BioSource Pharm, Inc. for consideration as follows:
- an up-front cash payment of \$618,560 (US\$400,000);
 - the issuance of 750,000 Series A preferred shares with a value of \$618,561 (US\$400,001) (Note 4 [a] [iii]); and
 - the issuance of 1,000,000 Series B preferred shares with a value of \$2 (US\$1) (Note 4 [a] [iii]).

The amount of \$1,237,123 (US\$800,002) has been recorded as technology licenses and is being amortized on a straight line basis over ten years. The Series A and Series B 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 (Note 4(a)(ii) and (iii)). The Company is also obligated in the future to pay:

- up to US\$3,000,000 cash if certain drug development milestones are achieved; and
- royalties on future product sales

- [b] On September 12, 2002, the Company acquired a portfolio of antiviral technologies and product candidates pursuant to a Call for Tenders in the bankruptcy of Originix Technologies Inc. and entered into a collaboration and license agreement with Hybridon, Inc. in respect of one of the acquired technologies (the "HPV oligonucleotide drug candidate") for consideration as follows:
- \$817,260 in cash and the issuance of 250,000 Series C Preferred Shares with a value of \$396,575 (US\$250,000) (Note 4(a)(iv));
 - milestone payments of up to US\$5,250,000 upon the achievement of specified drug development milestones for the HPV oligonucleotide drug candidate in accordance with the Series C preferred shares (Note 4(a)(iv)); and
 - royalties on future product sales of the HPV oligonucleotide drug candidate.

The amount of \$1,213,835 has been recorded as technology licenses and is being amortized on a straight line basis over ten years.

4. SHARE CAPITAL

[a] Issued and outstanding

[i] Common shares

	Number of Shares (thousands)	Amount \$ (thousands)
Balance, April 30, 2002	39,474	96,358
Private placement with senior executives	48	43
Private placement with Biotech Value Fund	7,850	5,495
Balance, January 31, 2003	47,372	101,896

On August 26, 2002, the Company issued 48,100 common shares at the market price of \$0.90 per common share for proceeds of \$43,290 pursuant to a private placement with four senior executives.

Nine months ended January 31, 2003 (Unaudited—Canadian dollars)

On December 3, 2002, the Company issued 7,850,000 common shares for proceeds of \$5,495,000. Additionally, the Company issued warrants to purchase (i) 987,500 common shares at \$1.50 per common share; and (ii) 982,914 common shares at \$3.00 per common share. These warrants, subject to certain earlier expiry provisions, expire December 5, 2005 and December 3, 2007, respectively. The warrant holders, pursuant to the terms of the warrants, can elect, when exercising their warrants, to satisfy their obligation to pay the exercise price to the Company by accepting a lesser number of common shares.

[ii] Preferred shares, Series A

	Number of Shares (thousands)	Amount \$ (thousands)
Balance, April 30, 2002	—	—
Issued pursuant to asset acquisition (note 3(a))	750	619
Redeemed by cash payment	(400)	(619)
Balance, January 31, 2003	350	—

During the quarter ended October 31, 2002, the Company paid US\$400,000 on redemption of 400,000 Series A preferred shares. The remaining 350,000 Series A preferred shares are, at the Company's option, either convertible into common shares of the Company or redeemable for cash at US\$1 per Series A preferred share, from time to time upon the achievement of specified drug development milestones in the lipopeptide and polyene programs.

If the Company elects to convert any of the Series A preferred shares into common shares the conversion will be based upon the average closing price of the Company's common shares on the Toronto Stock Exchange for the 5 trading days prior to the applicable conversion date (the "Conversion Price"). If the average closing price of the Company's common shares for the 20 trading days subsequent to a conversion date is less than the Conversion Price the Company is obligated to pay the difference in cash for the applicable number of common shares.

Effective May 19, 2010, the Company can redeem the then outstanding Series A preferred shares for an aggregate value of US\$1. As the achievement of the specified milestones for the redemption or conversion of the remaining 350,000 Series A preferred shares are uncertain, these Series A preferred shares have been recorded at an aggregate value of US\$1.

[iii] Preferred shares, Series B

	Number of Shares (thousands)	Amount \$ (thousands)
Balance, April 30, 2002	—	—
Issued pursuant to license and collaboration agreement (note 3(a))	1,000	—
Balance, January 31, 2003	1,000	—

The Series B preferred shares are, at the Company's option, either convertible into common shares of the Company or redeemable for cash at US\$1 per Series B preferred share from time to time upon the achievement of specified drug development milestones in the lipopeptide and polyene programs.

If the Company elects to convert any of the Series B preferred shares into common shares the conversion will be based upon the average closing price of the Company's common shares on the Toronto Stock Exchange for the 5 trading days prior to the applicable conversion date (the "Conversion Price"). If the average closing price of the Company's common shares for the 20 trading days subsequent to a conversion date is less than the Conversion Price the Company is obligated to pay the difference in cash for the applicable number of common shares.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS, CONTINUED

Nine months ended January 31, 2003 (Unaudited—Canadian dollars)

4. SHARE CAPITAL, CONTINUED

[a] Issued and outstanding, continued

[iii] Preferred shares, Series B, continued

Effective May 19, 2010, the Company can redeem the then outstanding Series B preferred shares for an aggregate value of US\$1. As the achievement of the specified milestones for the redemption or conversion of 1,000,000 Series B preferred shares are uncertain, the Series B preferred shares have been recorded at an aggregate value of US\$1.

[iv] Preferred shares, Series C

	Number of Shares (thousands)	Amount \$ (thousands)
Balance, April 30, 2002	—	—
Issued in settlement of license fee payable (note 3(b)(i))	250	397
Issued pursuant to license and collaboration agreement (note 3(b)(ii))	5,250	—
Balance, January 31, 2003	5,500	397

On December 17, 2002, the Company issued 5,500,000 Series C convertible, redeemable preferred shares in respect of the US\$5,500,000 in obligations described in Notes 3(b)(i) and (ii). The Series C 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. The Company is obligated to redeem or convert 250,000 of the Series C preferred shares on April 17, 2003 with the remaining 5,250,000 Series C preferred shares to be redeemed or converted from time to time upon the achievement of specified drug development milestones for the HPV oligonucleotide drug candidate.

If the Company elects to convert any of the Series C preferred shares into common shares the conversion price will be based upon the greater of: the average closing price of the Company's common shares on the Toronto Stock Exchange for the 5 trading days prior to the applicable conversion date (the "Average Price"); and \$0.88 per common share. If the Average Price is less than \$0.88 and/or the average closing price of the Company's common shares for the 20 trading days (or such longer period as may be determined based on the average trading volume of the Company's common shares) subsequent to a conversion date is less than the Average Price, the Company is obligated to pay the difference in cash for the applicable number of common shares.

Effective December 16, 2010, the Company can redeem the then outstanding Series C preferred shares for an aggregate value of US\$1. As the achievement of the specified milestones for the redemption or conversion of 5,250,000 Series C preferred shares are uncertain, the Series C preferred shares have been recorded at an aggregate value of US\$250,001.

[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 (thousands)	Weighted Average Exercise Price \$
Balance, April 30, 2002	2,658	2.20
Options granted	789	0.84
Options forfeited/expired	(234)	(4.71)
Balance, January 31, 2003	3,213	1.69

The stock options expire at various dates between March 9, 2003 and August 31, 2011.

Nine months ended January 31, 2003 (Unaudited—Canadian dollars)

[ii] As permitted by CICA Handbook Section 3870 *Stock-Based Compensation and Other Stock-Based Payments*, the Company has adopted the disclosure only provisions of Section 3870 for disclosing compensation cost based on the fair value accounting method for options granted to employees and directors. No compensation expense is recognized when stock options are granted to employees and directors, as the exercise price of each option approximates the market price on the date immediately preceding the grant. The following pro forma financial information presents the net loss and net loss per common share had the Company recognized stock based compensation for options awarded to employees and directors during the three and nine month periods ended January 31, 2003 using the fair value accounting method.

	Three months ended January 31, 2003 (thousands, except per share amounts)	Nine months ended January 31, 2003 (thousands, except per share amounts)
Net loss for the period as reported	(3,972)	(7,944)
Compensation expense under CICA 3870	(34)	(172)
Proforma net loss	(4,006)	(8,116)
Proforma basic and diluted loss per share	(0.09)	(0.20)

Under the transitional provisions of Section 3870, comparative figures are not required.

The estimated fair value of stock options issued during the nine months ended January 31, 2003 was determined using the Black-Scholes option pricing model using the following weighted average assumptions, resulting in a weighted average fair value of \$0.62 per option:

Annualized volatility	92.1%
Risk-free interest rate	3.4%
Expected life of options in years	5.0
Dividend yield	0.0%

5. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

6. SUBSEQUENT EVENTS

[a] The Company granted options to an employee to acquire 5,000 common shares with an exercise price of \$0.65 and expiry dates through February 2, 2011.

[b] The action commenced by a former executive [see Note 10 (c) (ii) to April 30, 2002 audited financial statements] went to trial in February 2003 and a decision was received March 17, 2003. The action was dismissed with costs awarded to the Company. The former executive may seek to appeal the decision and if appealed, the Company is unable to predict the outcome. The Company continues to believe that no provision is required.



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