

# OUR TARGET

2008 first quarter report

Proto**x**  
THERAPEUTICS

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following management's discussion and analysis ("MD&A") has been prepared as of May 12, 2008 and should be read in conjunction with our audited financial statements for the year ended December 31, 2007 and the Company's Annual Information Form, dated April 14, 2008 (collectively known as the "Financial Statements"). All the financial information has been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and all dollar amounts are expressed in Canadian dollars unless otherwise noted.

Additional information relating to Protox Therapeutics Inc., including the Company's Financial Statements, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **FORWARD-LOOKING STATEMENTS**

Certain statements and information in this MD&A contain forward-looking information within the meaning of applicable Canadian securities laws. Such forward-looking statements or information include, but are not limited to, statements or information with respect to our intent, belief or current expectations primarily with respect to the regulatory approvals, market and general economic conditions, future costs, expenditures and our future operating performance related to the future success and commercialization of our development programs. Often, these statements include words such as "plans", "expects", "estimates", "forecasts", "intends", "anticipates" or "believes" or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved. With respect to forward-looking statements and information included herein, we have made numerous assumptions including among other things, assumptions about our future financing requirements and our ability to meet our obligations, our ability to meet regulatory requirements, the anticipated market for our products and our ability to achieve our goals. Even though our management believes that the assumptions made and the expectations represented by such statements or information are reasonable, there can be no assurance that the forward-looking statement will prove to be accurate. By their nature, forward-looking statements and information are based on assumptions and involve known and unknown risks, uncertainties and other factors, many of which are beyond the Company's control that may cause our actual results to differ materially from those that are expressed or implied by such forward-looking information. Such risks, uncertainties and other factors include, among other things, the following: negative results from our clinical studies, drug product supply for our clinical trials, inability to fund our development programs, program delays that may occur due to reliance on third-party service providers, raw material and operating costs, changes in government regulation, fluctuations in demand and supply for our products, industry production levels, general economic and business conditions, our ability to execute our business plan and those additional risks set forth under the heading "Risk Factors" in our Annual Information Form for our financial year ending December 31, 2007. Should one or more of these risks or uncertainties materialize, or should assumptions underlying the forward-looking statements or information prove incorrect, actual results may vary materially from those described herein as intended, planned, anticipated, believed, estimated or expected. Accordingly, readers should not place undue reliance on forward-looking statements or information. We undertake no obligation to reissue or update forward-looking statements or information as a result of new information or events after the date hereof except as may be required by law. All forward-looking statements and information made in this document are qualified by this cautionary statement.

## **COMPANY OVERVIEW**

Protox Therapeutics Inc. (the "Company" or "Protox") is a biopharmaceutical company focused on the research, development and commercialization of receptor targeted fusion proteins. These fusion proteins specifically deliver potent payloads derived from engineered bacterial toxins or fully human Bcl-2 derived proteins to target cancer and other diseased cells. Protox is advancing a pipeline of discovery and clinical-stage product candidates developed from three complementary technology platforms: PORxin™, INxin™ and HUMxin™. The Company's lead drugs in clinical development include the PORxin candidate, PRX302, for the treatment of localized prostate cancer and benign prostatic hyperplasia ("BPH"), commonly known as enlarged prostate, and the INxin candidate, PRX321, for primary brain cancer and other solid tumours.

PORxin drugs are inactive pro-toxins that bind to cell surface receptors and are activated by specific proteases produced at elevated levels by target cells. Once activated, the toxin inserts in the cell membrane creating large pores on the cell surface. Leakage of cellular contents and loss of membrane integrity ultimately causes cell death, also known as apoptosis. PRX302, our lead candidate from the PORxin platform, is activated on the surface of prostate cells by the protease, prostate specific antigen ("PSA"), which is over-produced in patients with prostate cancer and BPH. A Phase 1 clinical trial for the treatment of localized, recurrent prostate cancer with PRX302 has been completed and final results from the study were announced on November 1, 2007. Based on the encouraging results of this study, a Phase 2a clinical trial was initiated in January 2008 and patient screening has commenced. PRX302 has also been evaluated in a Phase 1 clinical trial for the treatment of BPH. This study was completed in 2007 and final results were announced on January 3, 2008. In view of the promising results and our receipt of Health Canada and Institutional Review Board ("IRB") approval as announced on April 8, 2008, the Company has commenced a Phase 2 clinical trial for further evaluation of PRX302 in the treatment of BPH.

INxin drugs target cancer cells that over-express specific tumour associated receptors on their cell surface. Once bound to the cancer cells, INxin drugs enter the cell and inhibit protein synthesis which ultimately leads to cell death. PRX321, a lead candidate from the INxin platform, has been engineered to target interleukin-4 receptors (IL-4R), which are known to be over-expressed on the surface of several types of cancer. A Phase 2a clinical trial has been completed with PRX321 for the treatment of primary brain cancer, specifically recurrent malignant glioblastoma multiforme ("GBM") and anaplastic astrocytoma ("AA"). A Phase 1 clinical trial has also been completed for peripheral solid tumours, specifically renal cell carcinoma and non-small cell lung cancer. PRX321 is also in pre-clinical development for other peripheral solid tumours and haematological tumours. Planning as well as the manufacture of a new GMP (Good Manufacturing Practices) batch of PRX321 continues in preparation for a PRX321 Phase 2b (pre-pivotal) clinical trial for the treatment of primary brain cancer with clinical trial initiation anticipated during 2008 H2. PRX321 has received both Fast Track Designation and Orphan Drug Designation from the U.S. Food and Drug Administration ("FDA") for primary brain tumours. Fast Track Designation enables expedited review by the FDA of products that are in clinical development and Orphan Drug Designation provides a number of benefits including seven years of market exclusivity subsequent to marketing approval. In January 2008, an application was submitted to the European Medicines Agency ("EMA") to obtain Orphan Drug Designation in Europe, which would afford ten years of market exclusivity following marketing approval.

## **COMPANY OVERVIEW (continued)**

HUMxin, a next-generation platform technology acquired in 2007, is a program being developed in collaboration with the U.S. National Institutes of Health. The objective of this discovery stage program is to develop novel receptor targeted fusion proteins, using the fully human Bcl-2 family of proteins as payloads, in order to accelerate or prevent apoptosis.

In addition to actively developing PRX302 and PRX321 in multiple active and currently planned clinical trials, the Company plans to work in partnership with the co-inventors of the PORxin, INxin and HUMxin technologies as well as other leading scientists to continue the development of our lead candidates as well as strengthen our product pipeline through the discovery and development of additional novel drug candidates.

## **RESEARCH & DEVELOPMENT UPDATE**

### **PORxin Platform**

#### **Prostate Cancer**

##### **U.S. Phase 1 Clinical Trial**

During 2006 Q2, the Company initiated a Phase 1 clinical trial of PRX302 in the United States ("U.S."). The multi-center, open-label, dose-escalation study was intended to examine the safety and tolerability of PRX302 as a primary endpoint and therapeutic activity as a secondary endpoint in patients with biopsy proven localized recurrent prostate cancer following radiation therapy that showed signs of disease progression as evidenced by rising levels of PSA.

Patient enrolment was completed in June, 2007 and on November 1, 2007, the Company announced final results from this Phase 1 clinical trial indicating that PRX302 was well tolerated and showed encouraging early signs of therapeutic activity following a single intra-prostatic administration. A total of 24 patients were treated in this study at 5 trial sites in the U.S.

No significant safety issues relating to PRX302 treatment were encountered in this clinical trial. One patient in the study, who met inclusion criteria in spite of having borderline liver abnormalities, showed a transient rise in liver enzymes (Grade 3 on the National Cancer Institute's 5-stage grading scale) that quickly returned to screening levels. An expanded cohort was enrolled at this dose in order to collect additional safety data. No safety issues were observed in any patients within the expanded cohort or in further cohorts that received higher doses. In summary, no serious adverse events were reported relating to PRX302 and all other adverse events reported were mostly associated with the injection procedure, rating no higher than Grade 1 (mild).

Assessment of potential therapeutic activity was determined by measuring PSA levels throughout the study and conducting prostate biopsies at 30 days post-treatment. A comparison of prostate biopsies taken at baseline and day 30 post treatment showed that 18 of the 24 patients tested in this trial had a decrease in the percentage of cancer-positive biopsies. Three patients showed no detectable adenocarcinoma in their day 30 biopsy. Results showed that in 21 of the 24 patients a decrease in PSA levels below screening levels were observed at 30 days or longer post-treatment while in 15 of 24 patients PSA levels continued to be below screening levels or stable at 90 days or longer. Comparison of PSA levels pre and post treatment showed a desirable trend towards an

## **RESEARCH & DEVELOPMENT UPDATE (continued)**

increase in PSA doubling time ("PSADT") in 19 of 24 patients and a decrease or stable PSA velocity ("PSAV") in 17 of 24 patients, both of which are positive outcomes for the patient.

Protox has concluded that, despite a 100-fold escalation in dose, the maximum tolerated dose ("MTD") was not reached in this study while evidence of therapeutic activity was observed.

### U.S. Phase 2a Clinical Trial

Following the positive Phase 1 study results, the Company announced on January 15, 2008 that IRB approvals had been received to proceed with a multi-centre Phase 2a study evaluating PRX302 for the treatment of up to 24 patients with locally recurrent prostate cancer following primary radiation therapy. Patient screening and enrolment has commenced at the U.S. study sites. The objective of this study is to optimize dosing volume and injection regimen in order to improve local distribution and further enhance therapeutic activity of PRX302. The assessment of therapeutic activity will be based on the level of decrease in both PSA levels and tumour burden and increase in PSADT following treatment. In addition, the study will also evaluate the safety and tolerability of the different dosing volumes and injection regimens.

### **Benign Prostatic Hyperplasia**

#### Canada Phase 1 Clinical Trial

In 2006 Q4, the Company obtained approval from Health Canada to begin a Phase 1 clinical trial of PRX302 for BPH and the first patient was enrolled in April, 2007.

This study was an open-label, multi-centre, dose escalation study where the primary endpoint was safety and tolerability following a single intra-prostatic administration of PRX302. The secondary endpoint was to determine therapeutic activity as measured by the change in International Prostate Symptom Score ("IPSS") throughout the study, when compared to screening. In addition, changes in Quality of Life ("QoL") scores, prostate volume and urinary flow parameters were also monitored. Using a well-established, image-guided technique, PRX302 was administered directly into the prostate in a relatively simple procedure performed in the urologist's office.

Final results for this Phase 1 BPH study were announced on January 3, 2008. A total of 15 patients with moderate to severe BPH were treated in this trial. The dose was escalated 14-fold from cohort 1 to cohort 4, keeping the dosing volume constant, whereas one additional cohort received a 4-fold higher volume at the lowest dose. Most patients treated in this study were either refractory or intolerant to oral therapy.

Despite a 14-fold escalation in dose, no safety issues were identified and MTD was not reached in this study. Results indicate that PRX302 was well tolerated with no serious adverse events observed. Treatment related adverse events were generally reported as being mild or moderate, local and transient in nature.

Treatment related symptomatic relief was rapid and substantial benefits were noticed by day 30 post-treatment. Both symptom scores (IPSS and QoL) continued to show further improvements in all cohorts at the end of the active study period (day 90 post treatment) indicating a potential for sustained benefit following a single treatment with PRX302.

**RESEARCH & DEVELOPMENT UPDATE (continued)**

Across all treatment groups, IPSS scores showed a statistically significant improvement from screening to day 30 ( $p < 0.01$ ) and continued to day 90 post treatment ( $p < 0.001$ ). The mean IPSS values improved by an average of 4.8 points from  $19.1 \pm 4.3$  at screening to  $14.3 \pm 5.7$  at day 30 post treatment. By day 90, IPSS improved by an average of 8.5 points ( $10.6 \pm 5.9$ ).

Improvement in QoL scores were observed in all 5 cohorts. Independent of the treatment group, QoL scores improved from an average of  $4.3 \pm 1.1$  at screening to  $2.5 \pm 1.6$  by day 30 ( $p < 0.01$ ) and continued to show a 50% improvement by day 90 (QoL =  $2.1 \pm 1.6$ ;  $p < 0.01$ ). Furthermore, prostate volume decreased in all cohorts. Irrespective of cohort assignment, the mean prostate volume decreased by over 26% from 41.6 cc at screening to 30.5 cc at day 90 post treatment ( $p < 0.05$ ).

On April 16, 2008, the Company announced additional long-term data for this Phase 1 BPH study. The results indicate that encouraging signs of therapeutic activity continue to be seen at 6 months and 9 months following a single treatment with PRX302. At 6 months post treatment the mean IPSS values improved by an average of 6.4 points from  $19.1 \pm 4.3$  at screening to  $12.7 \pm 5.2$  at day 180 post treatment ( $p=0.0009$ ), with 6 of 15 patients showing a 10 point or greater improvement in IPSS values. For the 6 patients for whom 9 month data was available, IPSS values improved by an average of 6.1 points. With respect to QoL scores, they improved by 2.0 points from an average of  $4.5 \pm 1.1$  at screening to  $2.5 \pm 1.4$  by day 180 ( $p=0.0002$ ). For the 6 patients for whom 9 month data was available, QoL scores improved by an average of 2.3 points by day 270. The mean prostate volume decreased by over 22%, from 46.4 cc at screening to 35.8 cc at day 180 post-treatment and by 20% from 49.6 cc at screening to 39.7 cc at day 270 post treatment.

Canada Phase 2 Clinical Trial

Based on the encouraging data from the above Phase 1 clinical trial, a Clinical Trial Application ("CTA") to commence a Phase 2 clinical trial for the treatment of up to 30 subjects having moderate to severe BPH was submitted to Health Canada during March, 2008. On April 8, 2008, the Company announced the receipt of Health Canada and IRB approvals to proceed with the planned clinical trial and the commencement of study screening activities. The objective of this multi-center study will be to optimize dosing volume and injection regimen in order to improve local distribution and further enhance therapeutic activity of PRX302. The assessment of therapeutic activity will be based on measurement of IPSS throughout the study, as compared to initial screening. Furthermore, changes in QoL scores, prostate volume and urinary flow parameters will also be monitored. Patient enrolment in this Canadian trial is anticipated to commence during 2008 Q2.

**RESEARCH & DEVELOPMENT UPDATE (continued)**

**INxin Platform**

**Primary Brain Cancer**

Prior to the Company's acquisition of PRX321 / INxin platform from Neurocrine Biosciences Inc. ("Neurocrine") and the U.S. Public Health Service ("PHS") in July 2006, a total of 72 patients with glioma (66 patients with GBM and 6 patients with AA) had been treated with PRX321 in Phase 1 and Phase 2 clinical trials in the United States and Europe. In these trials, all of the patients had recurrent and progressive forms of glioma and PRX321 was infused into the brain using a technique called Convection Enhanced Delivery ("CED"). The results from these trials indicated PRX321 was well tolerated with minimal systemic toxicity. In these clinical trials, over 70% of non-resected patients had complete or partial necrosis (shrinkage) of their tumours, while median survival times increased by some 80% from 6 to nearly 11 months.

As noted above, PRX321 has received Orphan Drug Designation from the FDA for treatment of astrocytic glioma and Fast Track Designation for treatment of recurrent GBM. Fast Track Designation enables expedited review by the FDA of products that are in clinical development and Orphan Drug Designation provides a number of benefits including 7 years of market exclusivity subsequent to marketing approval. In January 2008, an application was submitted to EMEA to obtain Orphan Drug Designation in Europe, which would afford 10 years of market exclusivity following marketing approval.

Based on the encouraging Phase 1 and 2a results, and subject to successful completion of manufacture and release of a new GMP batch of PRX321 drug product and obtaining regulatory authorization to proceed, the Company anticipates initiating a Phase 2b (pre-pivotal) clinical trial with PRX321 in patients with primary brain cancer during 2008 H2. The Phase 2b (pre-pivotal) study will be based upon an optimized protocol developed in conjunction with PRX321 investigators and experts on CED and imaging technologies.

The Company entered into a manufacturing agreement with Dompé pha.r.ma S.P.A. ("Dompé") of Italy in July 2007 to manufacture GMP batches of PRX321 drug substance. Technology transfer and process scale-up activities were conducted in 2007 by Dompé in preparation for the manufacture of GMP compliant batches of PRX321 for the anticipated Phase 2b (pre-pivotal) clinical trial in patients with primary brain cancer. Process scale-up and manufacturing activities are continuing. AAI Pharma Inc. has been contracted to complete the 2008 Q3 manufacture of the PRX321 drug product (i.e., sterile finish and fill) for clinical use.

During 2007 Prottox also entered into a collaborative research and clinical development agreement with BrainLAB AG ("BrainLAB") of Germany for use of the BrainLAB proprietary drug delivery software iPlan® Flow in the anticipated aforementioned pre-pivotal primary brain cancer Phase 2b clinical trial of PRX321. BrainLAB will supply and install its iPlan Flow software at all clinical sites participating in the pre-pivotal trial. The software will incorporate patient-specific information to monitor and potentially predict drug distribution in and around the brain tumor being treated. Using the iPlan Flow software, neurosurgeons will be able to better plan treatments and optimize catheter placement for ideal delivery and distribution of PRX321.

## **RESEARCH & DEVELOPMENT UPDATE (continued)**

Additional research in collaboration with Dr. Yael Mardor (Sheba Medical Centre) and neurosurgeon Dr. Zvi Ram (Tel Aviv Medical Centre) commenced in 2007 H2 to further optimize the convection enhanced delivery of PRX321. This project was completed during 2008 Q1.

### **Peripheral Non-Central Nervous System (Non-CNS) Cancers**

In addition to the Phase 1 and Phase 2a primary brain cancer studies described above, Neurocrine also previously completed a Phase 1 safety study in patients with recurrent or unresponsive solid peripheral tumours that express the IL-4 receptor. 14 patients with either renal cell carcinoma ("RCC") or non-small cell lung cancer ("NSCLC") received three escalating doses of intravenously ("IV") administered PRX321 and MTD was established. 8 of the 12 evaluable patients with RCC had stable disease. Additional Phase 1/2 studies may be pursued based on interest from various institutions and investigators for the treatment of non-CNS peripheral solid tumours and/or haematological cancers that are known to over-express IL-4 receptors.

In 2007, Dr. Raj Puri of the FDA and co-inventor of PRX321 in collaboration with scientists at the National Cancer Institute, published new findings for PRX321 in the journal, *Cancer Research* (Volume 67(20), p. 9903-9912), showing that PRX321, when combined with gemcitabine, a chemotherapeutic agent currently used to treat advanced pancreatic cancer, was shown to have a synergistic anti-tumour effect both in vitro and in a clinically relevant mouse model of advanced pancreatic cancer. Specifically, those mice treated with a combination of PRX321 and gemcitabine showed a significant decrease in tumour burden and improved survival compared to treatment with either PRX321 or gemcitabine alone. The results showed that the combination approach was able to completely eradicate tumours in 40% of mice with established tumours and significantly prolonged survival of mice bearing advanced distant metastatic tumours. This study demonstrates for the first time the potential of combining PRX321 with a chemotherapeutic agent for treating patients with pancreatic cancer.

### **Collaborative Research**

As announced on April 30, 2008, the Company has entered into a collaboration with the FDA under the terms of a Cooperative Research and Development Agreement ("CRADA"). The collaborative research and development program will be conducted by the principal investigators Dr. Sam Denmeade, MD, Chief Scientific Officer of Protox and Dr. Raj Puri, MD, PhD, Director, Division of Cellular and Gene Therapies, Center for Biologics Evaluation and Research at the FDA. Dr. Puri is a co-inventor of PRX321 and a pioneer in the research of IL-4 receptors as a potential drug target in cancer and has published extensively in this area. The collaboration will focus on characterizing IL-4 receptors on various human tumours, determining the mechanism of up regulation of these receptors, developing assays and animal models to evaluate the safety and efficacy of IL-4 receptor-directed therapeutic agents, such as PRX321, and using laboratory analyses to assess the clinical potential of PRX321, either as a monotherapy or in combination with other therapeutic agents. In addition, novel compounds targeting IL-4 receptors will be engineered and tested. Under the terms of the CRADA, Protox has an exclusive option to license any future inventions developed under the research program. In addition to supporting our anticipated primary brain cancer Phase 2b (pre-pivotal) clinical trial, this collaboration will serve to demonstrate the full potential of PRX321 as a selective and potent therapeutic targeting a large number of tumours that over express IL-4 receptors.

## **RESEARCH & DEVELOPMENT UPDATE (continued)**

### **HUMxin Platform**

The HUMxin technology is based on fully human members of the Bcl-2 family of apoptotic proteins. The Bcl-2 family includes both pro-apoptotic and anti-apoptotic members. Pro-apoptotic proteins have been shown to induce tumor cell death whereas anti-apoptotic proteins can inhibit cell death. Due to its central role in the regulation of apoptotic cell death, the Bcl-2 pathway has attracted a considerable amount of interest from pharmaceutical companies.

The HUMxin technology represents an opportunity to potentially develop targeted therapeutics both for the treatment of various diseases, including solid tumors, metastases and hematological malignancies, and for the protection and/or regeneration of cells, tissues or organs after cancer treatment or stem cell transplantation. The HUMxin technology can also be used to treat neurodegenerative diseases, including neuronal injury.

Effective January 20, 2008, the Company extended its CRADA with the U.S. National Institute of Neurological Disorders and Stroke ("NINDS") by an additional 2 years to conduct research related to the HUMxin platform technology. Under the terms of the CRADA, the Company provides research funding to NINDS in exchange for an exclusive option to license inventions developed under the executed CRADA research plan.

## **INTELLECTUAL PROPERTY**

We regard our patent and other proprietary technology rights as one of the foundation blocks upon which we continue to build a successful biopharmaceutical development company and, therefore, we file patent applications to protect our proprietary discoveries.

Patents and patent applications covering the PORxin technology licensed or owned by the Company are currently being prosecuted under the following four patent families:

- i) Proaerolysin Containing Protease Activation Sequences and Methods of Use for Treatment of Prostate Cancer;
- ii) Method of Treating or Preventing Benign Prostatic Hyperplasia Using Modified Pore-Forming Proteins;
- iii) Modified Pore-Forming Protein Toxins and Use Thereof; and
- iv) Modified Protein Toxins and Use Thereof for Treating Disease

The INxin technology licensed by the Company is covered by issued patents under the following three patent families:

- i) Fusion Proteins Comprising Circularly Permuted Ligands;
- ii) Circularly Permuted Ligands and Circularly Permuted Chimeric Molecules; and
- iii) Convection-Enhanced Drug Delivery

As with the patent positions of other pharmaceutical, biopharmaceutical and biotechnology firms, we do not know whether any patent applications will result in the issuance of patents or, for patents that are issued, whether they will provide significant proprietary protection or will be circumvented or invalidated.

**PROTOX THERAPEUTICS INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**MARCH 31, 2008**

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**2008 Q1 HIGHLIGHTS**

- On January 3, 2008, the Company announced positive final results from the PRX302 Phase I BPH clinical trial and its intent to commence a Phase 2 study in Canada.
- On January 15, 2008, the Company announced the commencement of a U.S. Phase 2a clinical trial for the use of PRX302 as a treatment for localized, recurrent prostate cancer.
- On February 4, 2008 in conjunction with graduation from the TSX Venture Exchange, the Company's common shares commenced trading on the Toronto Stock Exchange.

**SUBSEQUENT HIGHLIGHTS**

- On April 8, 2008, Protox announced receipt of approvals from Health Canada and IRB to proceed with its planned Canadian Phase 2 clinical trial for the treatment of BPH.
- On April 15, 2008, the Company announced positive long-term data from its Phase 1 BPH study using PRX302 with results indicating that encouraging signs of therapeutic activity continue to be seen at 6 and 9 months following a single treatment.
- On April 30, 2008, Protox announced entering into collaboration with Dr. Raj Puri of the FDA under the terms of a CRADA focused on PRX321 and IL-4 receptor related research and development.
- On May 5, 2008, the Company announced it has retained an agent to raise gross proceeds of up to \$3.0 million pursuant to a brokered private placement of its common shares, with an over-allotment option to raise up to an additional \$3.0 million for maximum proceeds of \$6.0 million.

**SELECTED ANNUAL INFORMATION**

<b>Year ended December 31</b>	<b>2007 (audited)</b>	<b>2006 (audited)</b>	<b>2005 (audited)</b>
Loss and comprehensive loss	\$ (7,446,052)	\$ (5,012,646)	\$ (5,549,332)
Basic and diluted loss per share	(0.13)	(0.13)	(0.22)
Total assets	12,913,664	11,514,697	5,853,003

**RESULTS OF OPERATIONS**

The Company has not earned any revenue in any of its previous fiscal years, other than income from interest earned on the Company's cash balances.

Net Loss

For the three months ended March 31, 2008 ("2008 Q1"), the Company reported a net loss of \$2.0 million or \$0.03 per share compared to \$1.6 million or \$0.03 per share for the three months ended March 31, 2007 comparative period ("2007 Q1"). The \$0.4 million (27%) increase in net loss for 2008 Q1 is primarily attributable to increased research and development costs and advancing the Company's product pipeline as further discussed below.

**PROTOX THERAPEUTICS INC.**  
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**RESULTS OF OPERATIONS (continued)**

Research and Development Costs

Research and development ("R&D") costs of nearly \$1.46 million were incurred during 2008 Q1 compared to \$1.04 million for the 2007 Q1 comparative period. The \$0.42 million (40%) R&D cost increase reflects the expanded scope and advancement of Protox's drug development and clinical activities on a comparative basis. Incremental costs were incurred during 2008 Q1 for CMC (chemistry, manufacturing and control), clinical and regulatory preparatory activities in advance of the anticipated initiation of the Company's PRX321 Phase 2b (pre-pivotal) study for primary brain cancer in 2008 H2.

Direct costs for the PRX302 prostate cancer and BPH clinical programs and PRX321 Phase 2b (pre-pivotal) study preparatory and CMC activities totaled approximately \$0.7 million during 2008 Q1 compared to approximately \$0.5 million for 2007 Q1, contributing \$0.2 million (40%) to the overall increase in R&D costs for the quarter. A milestone payment relating to the PRX302 prostate cancer program was also a contributing factor to the increase in 2008 Q1 R&D costs. Discovery research costs for 2008 Q1 were \$0.17 million compared to \$0.1 million for 2007 Q1, reflecting incremental costs associated with additional CRADA activity and the operation of Company's own lab, which opened in 2007 Q3.

General and Administrative Costs

General and administrative ("G&A") costs of \$0.54 million were incurred during 2008 Q1 representing a 10% increase compared to \$0.49 million incurred for the 2007 Q1 comparative period. G&A costs will generally vary from period to period depending on the specific business development, market research and shareholder relations initiatives undertaken and related travel required at such time to support the Company's corporate objectives. The 2008 Q1 G&A costs increase is commensurate with the growth of the Company and its operations and also reflects an increase in business development personnel and activities.

Interest Income

During 2008 Q1, the Company earned interest income of \$0.09 million. Interest income earned during 2008 Q1 approximated the amount earned during 2007 Q1, with average cash balances and rate of returns being similar for both periods

Foreign Exchange Loss

During 2008 Q1, the Company recorded a cumulative foreign exchange gain of \$0.03 million compared to a loss of \$0.02 million for the 2007 Q1 comparative period. The foreign exchange loss recorded for a particular period and difference between comparative periods is a function of prevailing foreign exchange rates in effect at such time compared to the comparative period(s) as well as the amount of net financial assets or liabilities held or transacted during the subject periods. During 2008 Q1, the U.S. dollar gained approximately 3% against the Canadian dollar reversing some of its 15% decline during 2007.

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**MARCH 31, 2008**

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**SUMMARY OF QUARTERLY RESULTS**

Unaudited quarterly results prepared by management for the eight quarters to March 31, 2008:

(unaudited)	2008 Q1	2007 Q4	2007 Q3	2007 Q2
Interest income	\$ 87,908	\$ 99,134	\$ 63,692	\$ 95,995
Total expenses	2,166,597	2,411,616	1,773,141	1,913,014
Loss and comprehensive loss	(2,044,535)	(2,312,482)	(1,709,449)	(1,817,019)
Basic and diluted loss per share	(0.03)	(0.04)	(0.03)	(0.03)
(unaudited)	2007 Q1	2006 Q4	2006 Q3	2006 Q2
Interest income	\$ 93,039	\$ 42,854	\$ 32,991	\$ 35,750
Total expenses	1,700,141	1,370,812	1,384,481	1,514,123
Loss and comprehensive loss	(1,607,102)	(1,327,959)	(1,351,490)	(1,478,373)
Basic and diluted loss per share	(0.03)	(0.03)	(0.04)	(0.04)

The Company does not anticipate earning any revenue in the foreseeable future, other than interest revenue earned on its cash balances.

Expenses, in particular R&D costs, are influenced by a number of factors including the scope of clinical development and research programs pursued; the stage (i.e. Phase 1, 2 or 3) of clinical trials undertaken; the number of clinical trials that are active during a particular period of time; the rate of patient enrollment; and ultimately are a function of decisions made to continue the development and testing of a product candidate based on supporting safety and efficacy from clinical trial results. Consequently, expenses may vary from period to period. G&A expenses will be dependent on the personnel and infrastructure required to support the corporate, clinical and business development objectives and initiatives of the Company, however, no material increase in G&A costs is expected over the short term.

Total expenses during 2007 Q4 were higher than the other quarters presented above primarily due to incremental PRX321 CMC costs, more specifically, costs relating to the commencement of the manufacture of a new GMP batch of PRX321 product and the associated technology transfer activities during 2007 Q4 (approximately \$0.6 million impact).

**LIQUIDITY AND CAPITAL RESOURCES**

As at March 31, 2008, the Company had cash and cash equivalents of \$9.3 million compared to \$11.4 million as at December 31, 2007. The Company had working capital of \$8.1 million at March 31, 2008, compared to \$9.9 million at December 31, 2007.

Excluding warrants and stock option exercise proceeds, the Company consumed cash of \$2.1 million during 2008 Q1 to finance continuing operations compared to \$1.0 million for 2007 Q1. These expenditures principally related to funding the continuing operations and license agreement commitment payments of the Company and can be examined in more detail in the Statement of Cash Flows. The Company's average monthly consumption of cash for operating and investing activities during 2008 Q1 was \$0.71 million compared to \$0.33 million during the 2007 Q1 comparative period. The \$1.1M cash consumption increase from 2007 Q1 to 2008 Q1 is primarily attributable to the additional costs associated with the expansion and advancement of

**LIQUIDITY AND CAPITAL RESOURCES (continued)**

development and clinical trial activities for PRX302 and PRX321 relative to the comparative period, as discussed within the Results of Operations section above.

The Company will continue to finance itself through the sale of equity, as required, or pursue other funding sources available to the Company in the future. Further proceeds of up to \$7.1million from the exercise of the approximate 11.0 million warrants currently outstanding - exercisable at \$0.65 - to purchase common shares could be received hereafter up to December 2008 if all warrants are exercised. During 2007, 98.5% of the approximately 11.8 million November 2005 issued warrants were exercised prior to expiry resulting in proceeds of \$7.6 million. The exercise of any outstanding stock options could also provide additional cash resources. Additional funding could also be provided from collaborative arrangements established in the future with pharmaceutical or biotechnology companies in relation to products and technologies under development by the Company. The ability of the Company to continue as a going concern is dependent on its continuing ability to obtain the necessary financing to meet its obligations and pay its liabilities from normal operations when they become due and ultimately attaining profitable operations.

Management believes that current cash resources and expected cash flows should enable the Company to execute its business plan into 2009. However, the Company's working capital may not be sufficient to meet its stated business objectives in the event of unforeseen circumstances or a change in the strategic direction of the Company. When, or if, the Company requires additional capital, there can be no assurance that the Company will be able to obtain further financing on favourable terms, if at all.

On May 5, 2008, the Company announced it has retained an agent to raise gross proceeds of up to \$3.0 million pursuant to a brokered private placement of its common shares, with an over-allotment option to raise up to an additional \$3.0 million. If the private placement is successful, the additional cash resources will enable the Company to accelerate clinical programs and development activities.

**TRANSACTIONS WITH RELATED PARTIES**

During 2008 Q1, certain directors and a former officer, who remains a significant shareholder, have provided business advisory and scientific consulting services to the Company pursuant to consulting and other agreements. The Company incurred related expenses of \$41,580 for 2008 Q1 (2007 Q1 - \$64,395) under such agreements. These transactions were recorded at their exchange amounts. At March 31, 2008, \$13,860 was owed to these related parties and included in accounts payable (December 31, 2007 - \$nil).

## **CHANGES IN ACCOUNTING POLICIES**

### *Capital Disclosures*

On January 1, 2008, the Company prospectively adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535 *Capital Disclosures* ("Section 1535"). This new accounting standard establishes the requirements for disclosing information about an entity's capital and how it is managed. Section 1535 requires the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance. With Section 1535 relating to disclosure and presentation only, its adoption did not have an impact on our financial results.

### *Financial Instruments – Disclosure and Presentation*

On January 1, 2008, the Company prospectively adopted CICA Handbook Section 3862 *Financial Instruments – Disclosure* ("Section 3862") and CICA Handbooks Section 3863 *Financial Instruments – Presentation* ("Section 3863"). These sections provide enhanced and expanded disclosure requirements to complement the changes in accounting policy adopted on January 1, 2007 in accordance with Section 3855 *Financial Instruments – Recognition and Measurement*. As Sections 3862 and 3863 relate to disclosure and presentation only, their adoption did not have an impact on our financial results.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### *Use of estimates*

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could significantly differ from those estimates.

### *Intangible assets*

Intangible assets include proprietary rights, intellectual property, patent rights and technology rights which have been acquired from third parties. Intangible assets are recorded at cost less accumulated amortization. Following acquisition, the company evaluates the prospective commercialization of the acquired intangible asset. Depending upon the results of the evaluation, the Company commences amortization of the assets over their expected useful lives, which is generally less than 10 years.

### *Research and development costs*

R&D costs are charged as an expense in the period in which they are incurred. Development costs are charged as an expense in the period in which they are incurred unless they meet generally accepted criteria under Canadian GAAP for deferral and amortization. No development costs have been capitalized to date.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES (continued)**

### *Patent costs*

The costs incurred in establishing and maintaining patents for intellectual property developed are expensed in the period incurred.

### *Stock-based compensation*

The Company grants discretionary stock options for the purchase of common shares.

The Company accounts for all stock-based payments to employees and non-employees using the fair value based method. Under the fair value based method, stock-based payments to employees and non-employees are measured at the fair value of the equity instruments issued. The fair value of stock-based payments to non-employees is periodically re-measured until the services are provided or the options vest, and any change therein is recognized over the period.

## **ACCOUNTING PRONUCEMENTS FOR FUTURE ADOPTION**

### *Goodwill and intangible assets*

In January 2008, the CICA issued Section 3064 “*Goodwill and Intangible Assets*”. This new accounting standard, which is effective for fiscal periods beginning on or after January 1, 2009, replaces existing Section 3062 “*Goodwill and Other Intangible Assets*” and Section 3450 “*Research and Development Costs*” and establishes the standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company is currently assessing the future impact of this new standard on its financial statements.

### *International Financial Reporting Standards*

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards (“IFRS”) over a transition period expected to end in 2011. The Company is currently assessing the future impact of the transition to IFRS on its financial statements.

## **RISKS AND UNCERTAINTIES**

The Company is at an early stage of development and has incurred losses and will continue to incur losses in the foreseeable future. Developing new technologies will require further significant time and expense. It may be a number of years before the Company's technology begins to generate revenues, if at all. There can be no assurance that any of the Company's developments will be successful or successful enough to be commercially viable.

The Company is subject to risks, events and uncertainties, or “risk factors”, associated with being in the biopharmaceutical industry, and being an enterprise with projects in the research and development stage. Such risk factors could cause reported financial information to not necessarily be indicative of future operating results or of future financial position. The Company cannot predict all of the risk factors, nor can it assess the impact, if any, of such risk factors on the Company's business or the extent to which any factor, or combination of factors, may cause future results or financial position to differ materially from either those reported or those projected in any forward-looking statements. Accordingly, historical financial information and forward-looking statements should not be relied upon as a prediction of future results.

**RISKS AND UNCERTAINTIES (continued)**

Some of the risks and uncertainties affecting the Company, its business, operations and results include, but are not limited to: the Company's need for additional funding through to commercialization, which may not be available on acceptable terms or at all; the fact that the Company's success is dependent on its ability to obtain patents, licenses and government approvals to technology critical to the development of its business as well as meeting acceptable cost and performance criteria in the marketplace; the need to develop and commercialize products which will require time consuming and costly research and development, the success of which cannot be assured; the Company's dependency on third parties for cGMP grade materials, other materials and for research, development, manufacturing and commercialization assistance and support; the Company's dependency on assurances from, and performance by, third parties regarding licensing of proprietary technology owned by such parties or by others; government regulation and the need for regulatory approvals for both the development and commercialization of products, which are not assured; uncertainty that the Company's products, if ultimately commercialized, will be accepted in the marketplace; risks associated with research and development, including rapid technological change and competition from pharmaceutical companies, biotechnology companies and universities, which may make the Company's research, technology or products obsolete or uncompetitive; the need to attract and retain skilled employees and management; risks associated with claims of infringement of intellectual property and of proprietary rights, which may not be foreseeable or preventable; risks inherent in manufacturing, including scale-up, and the need to manufacture to regulatory standards; product marketing; product liability and insurance risks; risks associated with pre-clinical studies and clinical trials, including the possibility that trials may be terminated early, delayed or unsuccessful; exchange rate fluctuations; political, economic and environmental risks; changes in business strategy or development plans; the Company's need to establish or maintain relationships with key customers, suppliers and service providers, which cannot be assured; and the risk of unanticipated expenses, any of which could cause the Company to reduce, delay or divest one or more of its research and development programs.

The Company's success is also dependent on a number of other significant risks and uncertainties. For additional information, refer to the section entitled "Liquidity and Capital Resources" set out above and the Company's Annual Information Form dated April 14, 2008.

**DISCLOSURE CONTROLS AND PROCEDURES**

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in filings is recorded, processed, summarized and reported within the time periods specified in the Canadian Securities Administrators' rules and forms. Our Chief Executive Officer and VP Finance and Operations have designed our disclosure controls and procedures, or caused them to be designed under their supervision, as of March 31, 2008 to provide reasonable assurance that material information relating to the Company was made known to them and reported as required.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our Chief Executive Officer and VP Finance and Operations are responsible for the design of internal controls over financial reporting, or for causing them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of external financial statements in accordance with Canadian GAAP as of March 31, 2008. Regardless of how well an internal control system is designed and operated, it can provide only reasonable, not absolute, assurance that it will prevent or detect. The Chief Executive Officer and VP Finance and Operations have evaluated the design of the Company's internal controls and procedures over financial reporting as of the end of the period covered by this annual filing, and believe the design to be sufficient to provide such reasonable assurance. There were no changes that occurred during 2008 Q1 that have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

## **OTHER MD&A REQUIREMENTS**

### **Outstanding Share Data**

As at May 12, 2008, the Company has 68,534,433 common shares issued and outstanding.

In addition, the Company has 5,571,035 options outstanding to purchase common shares of the Company, including 520,000 options granted to certain officers and employees in February 2008 to purchase common shares at an exercise price of \$0.87. Of the options outstanding, approximately 3.3 million are exercisable into an equivalent number of common shares of the Company at exercise prices ranging from \$0.10 to \$1.00 and with an average exercise price of \$0.73. The Company also has 10,938,882 warrants outstanding entitling the warrant holder to purchase common shares with an exercise price of \$0.65 per common share and an expiry date of either November 29, 2008 or December 22, 2008.

For a detailed summary of the outstanding securities convertible into, exercisable or exchangeable for voting or equity securities as at December 31, 2007, refer to Note 8(c) and (d) in the audited 2007 annual financial statements of the Company.

# **Protox Therapeutics Inc.**

## Unaudited Interim Financial Statements

For the three months ended March 31, 2008 and 2007

The interim balance sheet of Protox Therapeutics Inc. as at March 31, 2008 and the statement of operations, comprehensive loss and deficit and cash flows for the period ended March 31, 2008 have not been reviewed by the Company's auditors, PricewaterhouseCoopers LLP. These financial statements are the responsibility of the Company's management and have been reviewed and approved by the Company's Audit Committee and Board of Directors.

# Protox Therapeutics Inc.

## Interim Balance Sheets

	March 31, 2008 \$ (Unaudited)	December 31, 2007 \$ (Audited)
<b>Assets</b>		
Current assets		
Cash and cash equivalents	9,314,459	11,410,018
Other receivables	192,064	166,793
Prepaid expenses	15,823	29,953
	<b>9,522,346</b>	11,606,764
Property and equipment	139,383	165,608
Intangible assets (Note 6)	1,068,992	1,141,292
	<b>10,730,721</b>	12,913,664
<b>Liabilities</b>		
Current liabilities		
Accounts payable	1,052,704	742,609
Accrued liabilities	353,996	951,797
Current portion of lease obligations	4,995	8,575
	<b>1,411,695</b>	1,702,981
Long-term portion of lease obligations	6,656	7,736
	<b>1,418,351</b>	1,710,717
<b>Shareholders' equity</b>		
Common shares (Note 7(a))	28,276,051	28,246,445
Common share purchase warrants (Note 7(c))	1,574,641	1,578,781
Other equity (Note 7(d))	2,986,289	2,857,797
Deficit accumulated during the development stage	(23,524,611)	(21,480,076)
	<b>9,312,370</b>	11,202,947
	<b>10,730,721</b>	12,913,664

### Approved by the Board of Directors

/s/ Frank Holler

\_\_\_\_\_  
Director

/s/ Nitin Kaushal

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Director

The accompanying notes are an integral part of these financial statements.

# Protox Therapeutics Inc.

Interim Statements of Operations, Comprehensive Loss and Deficit (unaudited)

	<b>For the three months ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>Expenses</b>		
Research and development	<b>1,456,345</b>	1,041,294
General and administrative	<b>539,762</b>	490,577
Stock-based compensation (Note 7(b))	<b>131,957</b>	126,066
Amortization of property and equipment	<b>38,533</b>	23,895
	<b>2,166,597</b>	1,681,832
<b>Other income (expense)</b>		
Interest income	<b>87,908</b>	93,038
Interest expense	<b>(192)</b>	(1,040)
Foreign exchange gain (loss)	<b>34,346</b>	(17,269)
	<b>122,062</b>	74,730
<b>Loss and comprehensive loss for the period</b>	<b>(2,044,535)</b>	(1,607,102)
<b>Deficit accumulated during development stage, beginning of period</b>	<b>(21,480,076)</b>	(14,034,024)
<b>Deficit accumulated during development stage, end of period</b>	<b>(23,524,611)</b>	(15,641,126)
<b>Basic and diluted loss per share</b>	<b>(0.03)</b>	(0.03)
Weighted average number of outstanding shares	<b>68,511,636</b>	56,520,278

The accompanying notes are an integral part of these financial statements.

## Protox Therapeutics Inc.

### Interim Statements of Cash Flows (unaudited)

	For the three months ended March 31,	
	2008	2007
	\$	\$
<b>Cash flows from operating activities</b>		
Loss and comprehensive loss for the period	(2,044,535)	(1,607,102)
Items not affecting cash:		
Stock compensation expense (Note 7 (c))	131,957	126,066
Amortization of property and equipment	38,533	23,895
Amortization of intangible assets	72,300	42,346
Change in non-cash working capital:		
Other receivables	(25,270)	94,368
Prepaid expenses	14,130	20,712
Accounts payable	310,095	374,007
Accrued liabilities	(597,801)	(65,228)
	(2,100,591)	(990,936)
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(12,307)	-
<b>Cash flows from financing activities</b>		
Issuance of common shares on exercise of warrants	18,850	510,575
Issuance of common shares on exercise of stock options	3,150	-
Capital lease payments	(4,661)	(11,023)
	17,339	499,552
<b>Decrease in cash and cash equivalents</b>	<b>(2,095,559)</b>	<b>(491,384)</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>11,410,018</b>	<b>10,020,947</b>
<b>Cash and cash equivalents - end of period</b>	<b>9,314,459</b>	<b>9,529,563</b>
<b>Supplemental cash flow information</b>		
Interest received	117,088	25,132
Interest paid	192	1,587

The accompanying notes are an integral part of these financial statements.

# **Protox Therapeutics Inc.**

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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## **1. Nature of operations**

Protox Therapeutics Inc. (“Protox” or the “Company”) is amalgamated under the Company’s Act of British Columbia and commenced operations on January 11, 2002.

Protox is a development stage biopharmaceutical company that focuses on the research, development and commercialization of receptor targeted fusion proteins. These fusion proteins specifically deliver potent payloads derived from engineered bacterial toxins or fully human Bcl-2 derived proteins to target cancer and other diseased cells. The Company is considered to be in the development stage as most of its efforts have been devoted to basic research and development activities to date. The ultimate ability to continue operations is dependent upon obtaining additional financing, completing development and commercialization of its products and generating cash from operations.

## **2. Basis of presentation and significant accounting policies**

### **(a) Interim Statements**

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in Canada (“Canadian GAAP”) for interim financial statements and do not include all the information required for annual audited financial statements. They are consistent with the policies outlined in the Company’s audited financial statements for the year ended December 31, 2007 except as described in Note 3 below. The interim financial statements and related notes should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2007. When necessary, the financial statements include amounts based on informed estimates and best judgments of management. The results of operations and comprehensive loss for the interim periods reported are not necessarily indicative of results to be expected for the year.

### **(b) Development stage company**

The accompanying financial statements have been prepared in accordance with the provisions of Accounting Guideline No. 11 *Enterprises in the Development Stage* (Note 1).

### **(c) Comparative amounts**

Comparative amounts have been reclassified, where necessary, to conform with the financial statement presentation adopted in the current year.

## **Protox Therapeutics Inc.**

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### **3. New accounting policies**

#### **(a) Adoption of new accounting standards**

##### *Capital Disclosures*

On January 1, 2008, the Company prospectively adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535 *Capital Disclosures* (“Section 1535”). This new accounting standard establishes the requirements for disclosing information about an entity’s capital and how it is managed. Section 1535 requires the disclosure of (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

##### *Financial Instruments – Disclosure and Presentation*

On January 1, 2008, the Company prospectively adopted CICA Handbook Section 3862 *Financial Instruments – Disclosure* (“Section 3862”) and CICA Handbooks Section 3863 *Financial Instruments – Presentation* (“Section 3863”). These sections provide enhanced and expanded disclosure requirements to complement the changes in accounting policy adopted on January 1, 2007 in accordance with Section 3855 *Financial Instruments – Recognition and Measurement*.

Section 1535, Section 3862 and Section 3863 relate to disclosure and presentation only and did not have an impact on our financial results (see Notes 4 and 5).

#### **(b) Future accounting changes**

##### *Goodwill and Intangible Assets*

In January 2008, the CICA issued Section 3064 “*Goodwill and Intangible Assets*”. This new accounting standard, which is effective for fiscal periods beginning on or after January 1, 2009, replaces existing Section 3062 “*Goodwill and Other Intangible Assets*” and Section 3450 “*Research and Development Costs*” and establishes the standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company is currently assessing the future impact of this new standard on its financial statements.

##### *International Financial Reporting Standards*

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards (“IFRS”) over a transition period expected to end in 2011. The Company is currently assessing the future impact of the transition to IFRS on its financial statements.

## Protox Therapeutics Inc.

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### 4. Capital disclosures

The Company's objectives when managing capital are to safeguard its accumulated capital in order to maintain its ability to continue as a going concern and to advance its research, development and commercialization activities. The capital structure of the Company consists of shareholders' equity as well as the cash and cash equivalents and tax credit receivable balances.

The Company manages its capital structure and makes adjustments to it based on economic conditions and the risk characteristics of the underlying assets. The Company, upon approval from its board of directors, will balance its overall capital structure through new share or debt issuances or by undertaking other activities as deemed appropriate under specific circumstances.

The Company expects that its current capital resources will be sufficient to support its research and development plans and operations into 2009 Q2. The Company is not subject to externally imposed capital requirements.

### 5. Financial instruments and financial risk management

#### (a) Financial instruments

The Company has classified its financial instruments as follows:

Financial Instrument	Classification	Measurement	March 31, 2008 \$
Cash and cash equivalents	Held-for-trading	Fair value	9,314,459
Other receivables	Loans and receivables	Amortized cost using the effective interest method	192,064
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost using the effective interest method	1,406,700
Lease obligations (current and long term)	Other financial liabilities	Amortized cost using the effective interest method	11,651

Section 3855 requires that the carrying values of other receivables, accounts payable, accrued liabilities and lease obligations be amortized over their expected life using the effective interest method ("EIM"). Application of the EIM did not result in any significant differences in the Company's amortization and as such the carrying amount is a reasonable approximation of their fair values due to the short term nature of these instruments. The Company did not have any held-to-maturity or available-for-sale financial instruments, nor did it have any derivative products for the three months ended March 31, 2008.

## **Protox Therapeutics Inc.**

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### **5. Financial instruments (continued)**

#### **(b) Financial risk management**

The Company is exposed to certain financial risks, including credit risk, liquidity risk and market risk.

##### *Credit risk*

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and cash equivalents and other receivables. The Company invests its excess cash principally in highly rated government and corporate debt securities. The Company has established guidelines relative to diversification, credit ratings and maturities that maintain safety and liquidity. These guidelines are periodically reviewed by the Company's audit committee and modified to reflect changes in market conditions.

##### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. To the extent that the Company does not believe it has sufficient liquidity to meet its current obligations, the board of directors considers securing additional funds through equity, debt or partnering transactions. The board of directors approves the Company's annual operating and capital budgets as well as any material transactions outside the ordinary course of business.

##### *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or valuation of its financial instruments.

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than the Canadian dollar, primarily expenses for research and development incurred in US dollars ("USD") and Euros. The Company believes that the results of operations, financial position and cash flows would be affected by a sudden change in foreign exchange rates, but would not impair or enhance its ability to pay its USD and Euro denominated obligations. The Company manages foreign exchange risk by maintaining USD cash on hand to fund its short term USD forecasted cash expenditures. The Company does not currently view its exposure to the Euro as a significant currency risk due to the limited volume of transactions conducted by the Company in this currency. As at March 31, 2008, the Company was predominately exposed to currency risk through its cash and cash equivalents, accounts payable and accrued liabilities denominated in USD. As at March 31, 2008, USD denominated cash and cash equivalents totalled USD 1,335,292 (December 31, 2007 – USD 1,925,477) and USD denominated accounts payable and accrued liabilities totalled USD 354,511 (December 31, 2007 – USD 415,088). The Company was also exposed to currency risk through Euro denominated accounts payable and accrued liabilities of €400,000 (December 31, 2007 – €400,000).

## Protox Therapeutics Inc.

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### 5. Financial instruments (continued)

#### (b) Financial risk management (continued)

The Company is subject to interest rate risk on its cash and cash equivalents and believes that the results of operations, financial position and cash flows would not be significantly affected by a sudden change in market interest rates relative to the investment interest rates due to the short term nature of the investments. Excess cash is invested in highly rated investment securities at fixed interest rates with varying terms to maturity but generally with maturities of three months or less from the date of purchase. Cash held in the Canadian dollar savings account currently bears interest at a rate of 2.60%. As at March 31, 2008, cash and cash equivalents of \$9,314,459 (December 31, 2007 - \$11,410,018) consisted of highly liquid commercial paper and USD term deposits with maturity dates up to April 11, 2008 and interest rates up to 4.20%

The Company does not invest in equity instruments of other corporations. However, changes in the Company's equity price could impact its ability to raise additional capital.

### 6. Intangible assets

Intangible assets consist of the following:

(unaudited)	March 31, 2008		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
HUMxin patents and technology rights	209,680	29,954	179,726
INxin patents and technology rights	1,185,688	296,422	889,266
	1,395,368	326,376	1,068,992

### 7. Shareholder's equity

#### (a) Common shares

Authorized: Unlimited common shares without par value

Issued: 68,534,433 common shares without par value

	Number of shares	Amount \$
Balance at December 31, 2007	68,473,933	28,246,445
Issuance of common shares on exercise of warrants	29,000	22,991
Issuance of common shares on exercise of stock options	31,500	6,615
Balance at March 31, 2008	68,534,433	28,276,051

## Protox Therapeutics Inc.

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

### 7. Shareholder's equity (continued)

#### (b) Stock options

Under the Company's stock option plan, the Company may grant stock options to employees, directors, officers, scientific advisory board members and consultants and is authorized to issue up to 10% of the issued and outstanding common shares upon exercise of such stock options. The board of directors or a committee appointed by the board administers the plan and determines the vesting and terms of each award. The stock options have vesting periods of up to 4 years and an exercise period of up to 5 years.

A summary of the activity of the Company's stock option plan for employees, directors and non-employees during the period is presented below:

	Number of options	Weighted average exercise price \$
Balance outstanding at December 31, 2007	4,980,035	0.73
Options granted	680,000	0.84
Options forfeited	(57,500)	0.80
Options exercised	(31,500)	0.10
Balance outstanding at March 31, 2008	5,571,035	0.75

The following table summarizes information about stock options outstanding at March 31, 2008 for employees, directors, officers, scientific advisory board members and consultants:

Exercise price \$	Number outstanding	Options outstanding		Options exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable	Weighted average exercise price \$
0.10	315,000	0.2	0.10	315,000	0.10
0.50	473,535	0.5	0.50	473,535	0.50
0.51 - 0.54	670,000	3.0	0.52	453,332	0.52
0.64	225,000	3.9	0.64	175,000	0.64
0.75 - 0.80	1,648,500	4.0	0.77	531,166	0.77
0.87	520,000	4.9	0.87	-	-
0.90	150,000	4.4	0.90	-	-
1.00	1,569,000	1.9	1.00	1,328,010	1.00
	5,571,035	2.9	0.75	3,276,043	0.72

The Company granted 680,000 options to certain employees and officers during the three months ended March 31, 2008 with an average exercise price of \$0.84.

## Protox Therapeutics Inc.

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### 7. Shareholder's equity (continued)

#### (b) Stock options (continued)

Stock-based compensation expense relating to stock options for the three months ended March 31, 2008 was \$119,262 (March 31, 2007 - \$123,649) for employees and \$12,695 (March 31, 2007 - \$2,417) for non-employees for a combined amount of \$131,957 (March 31, 2007 - \$126,066).

The fair value of each stock option granted to employees, directors and non-employees was estimated using the Black-Scholes option pricing model with the following assumptions:

Three months ended March 31,	2008	2007
Expected life of the options	3 years	3 years
Volatility	60 - 73%	77%
Dividend yield	0%	0%
Risk-free interest rate	3.19 - 3.75%	4.20%

#### (c) Warrants

At March 31, 2008, the Company had warrants to purchase common shares outstanding as follows:

Number of warrants	Expiry date	Exercise price \$
9,948,507	November 29, 2008	0.65
990,375	December 22, 2008	0.65
10,938,882		0.65

The following table summarizes the continuity of the Company's warrants:

	Number outstanding	Weighted average exercise price \$	Fair value at date of grant \$
Balance at December 31, 2007	10,967,882	0.65	1,578,781
Exercised	(29,000)	0.65	(4,140)
Balance at March 31, 2008	10,938,882	0.65	1,574,641

## **Protox Therapeutics Inc.**

Notes to the Interim Financial Statements

For the three months ended March 31, 2008 and 2007 (unaudited)

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### **7. Shareholder's equity (continued)**

#### **(d) Other equity**

At March 31, 2008, the Company had other equity recorded as follows:

	Amount \$
Balance at December 31, 2007	2,857,797
Stock compensation expense	131,957
Issuance of common shares on exercise of stock options	(3,465)
Balance at March 31, 2008	2,986,289

### **8. Related party transactions**

During the three months ended March 31, 2008, certain directors and a former officer, who remains a significant shareholder, provided business advisory and scientific consulting services to the Company pursuant to consulting and other agreements. The Company incurred related expenses of \$41,580 (March 31, 2007 - \$64,395) under such agreements. These transactions were incurred in the normal course of business and recorded at their exchange amounts. As at March 31, 2008, \$13,860 was owed to these related parties and included in accounts payable (December 31, 2007 - \$nil).

### **9. Segmented information**

The Company identifies its operating segments based on business activities, management responsibility and geographical location. The Company operates within a single operating segment, being the research and development of receptor targeted fusion proteins and operates in one geographic area, being Canada. All of the Company's assets are located in Canada.

### **10. Subsequent event**

On May 5, 2008, the Company announced it has retained an agent to raise gross proceeds of up to \$3,000,000 pursuant to a brokered private placement offering of its common shares, with an over-allotment option to raise additional proceeds of up to \$3,000,000.