

Protox

THERAPEUTICS

*Management Discussion and Analysis
Quarter Ended June 30, 2006*

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management discussion and analysis has been prepared as of August 8, 2006 (the MD&A) and should be read in conjunction with the unaudited financial statements and related notes for the Company for the three and six months ended June 30, 2006, as well as our audited financial statements for the year ended December 31, 2005, their related notes and the management discussion and analysis included in the 2005 Annual Report. All the financial statements have been prepared in accordance with Canadian generally accepted accounting principles. All dollar amounts are expressed in Canadian dollars unless otherwise specified. Additional information relating to Protox Therapeutics Inc. (Protox or the Company) can be found on SEDAR at www.sedar.com.

Forward Looking Statements

This MD&A may contain forward looking statements. Forward looking statements are statements about the future and are inherently uncertain and can be identified by forward looking terminology such as will, expected, planned, intended to, is being designed, potentially, anticipates and similar expressions or variations thereon, by reference to future dates or events, or that events or conditions will, may, could or should occur. Forward-looking statements are based on the beliefs, opinions and expectations of the Company's management at the time they are made, and the Company does not assume any obligation to update its forward-looking statements. Actual results may differ materially from those contemplated in forward looking statements due to a variety of uncertainties and risks. See Risks and Uncertainties below for a discussion of some of the risks, uncertainties and other factors which may cause actual results to vary materially from current results or the Company's anticipated future results.

The Company

Overview

Protox Therapeutics Inc. is a Canadian biotechnology company focused on the development and commercialization of targeted therapeutics for the treatment of cancer and other proliferative diseases. Through the Company's PORxin™ and INxin™ technology platforms, therapeutic candidates are generated by engineering the naturally occurring toxins, proaerolysin and *Pseudomonas* exotoxin .

PORxin™ is progressing well in Phase I clinical trials for localized recurrent prostate cancer and the Company will soon be submitting a Clinical Trial Application (CTA) to Health Canada in order to commence a Phase I trial for benign prostatic hyperplasia (BPH). INxin™ was acquired from Neurocrine Biosciences Inc. and the United States Public Health Service (PHS) on July 20, 2006 to accelerate our path toward becoming the world leader in the development of targeted toxin therapeutics. PORxin™ and INxin™ are complementary targeted toxin programs and fall directly within our core areas of expertise. INxin™ substantially expands our clinical pipeline, which now targets serious indications such as brain, prostate, kidney, and lung cancers that have large unmet medical needs. The acquisition of INxin™ also provides us with Fast Track Designation and Orphan Drug Status for brain cancer.

INxin™ drugs target cancer cells that produce specific tumor 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. A Phase II clinical trial has been completed with Protox's

lead compound, PRX321, for the treatment of primary brain cancer, specifically recurrent malignant glioblastoma multiforme and astrocytoma. A Phase I clinical trial has also been completed for both renal cell carcinoma and non-small cell lung cancer. PRX321 is also in pre-clinical development for other peripheral solid tumors and hematological tumors.

PRX321 has received both Fast Track Designation and Orphan Drug Status from the U.S. Food and Drug Administration (FDA) for primary brain tumors. Fast Track Designation enables expedited review by the FDA of products that are in clinical development and Orphan Drug Status provides a number of benefits including seven years of market exclusivity.

PORxin™ drugs are prodrugs that are activated by specific proteases produced in elevated levels by target cells. Once activated, the drug punches holes in the cells causing the contents to leak out and ultimately cell death. Protox is currently conducting Phase I clinical trials with PRX302 for the treatment of localized recurrent prostate cancer. Patient enrolment for the Phase I trial commenced after clinical site initiation in Q2 of 2006 and the first patient was dosed on May 2, 2006. The Company is planning to treat between 20 and 30 patients in the Phase I study and enrollment is expected to be completed by the end of 2006.

PRX302 is also being developed for the treatment of benign prostatic hyperplasia (BPH), more commonly known as an enlarged prostate. The Company is preparing a Clinical Trial Application (CTA) for submission to Health Canada to commence a Phase I clinical trial with PRX302 for the treatment BPH. The application is expected to be filed with Health Canada in Q3, 2006.

The Company continues to work in partnership with scientists at the FDA and National Institute of Health (NIH) to develop INxin™ for the treatment of other cancers and with scientists at the University of Victoria and Johns Hopkins University to develop other novel forms of PORxin™.

2006 Highlights:

- On January 16, 2006, the Company received clearance from the FDA to commence a Phase I clinical trial for the treatment of localized recurrent prostate cancer using PRX302.
- On April 3, 2006, the Company presented additional preclinical data at the American Association of Cancer Research (AACR) meeting, demonstrating PRX302's validity as a treatment for prostate cancer and benign prostatic hyperplasia.
- On May 2, 2006, the first patient was treated with PRX302 in the Phase I trial for the treatment of localized recurrent prostate cancer.
- On June 14, 2006, the Company filed a provisional patent application with the United States Patent and Trademark Office entitled "Modified Protein Toxins and Use Thereof for Treating Disease". The patent application provides added protection for drug candidates generated through the PORxin™ platform whose binding sites are altered to target certain types of cells including cancer cells.
- On July 20, 2006, the Company acquired a Phase II clinical stage program (INxin™) for the treatment of cancer from Neurocrine Biosciences Inc. and the United States Public Health Service (PHS).

Results of Operations

The Company commenced operations in January 2002 and has not been profitable since its inception. The Company is a development stage company and has focused its resources to the research and development of targeted therapeutics. The company has incurred a cumulative deficit of \$11.4 million to June 30, 2006.

The loss for the three months ended June 30, 2006 was \$1,478,373 (\$0.04 per share) compared with a loss of \$1,548,762 (\$0.07 per share) for the same period last year and a loss of \$854,824 (\$0.02) for the three months ended March 31, 2006. The increase in the loss for the second quarter of 2006 compared with the first quarter of 2006 is principally attributable to the PRX302 Phase I clinical trial costs for the treatment of localized prostate cancer, which commenced in May 2006.

The loss for the six months ended June 30, 2006 was \$2,333,197 (\$0.06 per share) compared with a loss of \$2,531,675 (\$0.11 per share) for the same period last year. The decrease in net loss for the six months ended June 30, 2006 compared with the same period last year is primarily due to the transition of PRX302 from preclinical research to human clinical trials. There were no preclinical costs for PRX302 in the first half of 2006 compared with a significant amount of preclinical and manufacturing costs during the same period last year.

Research and Development

Research and development expenses increased in the quarter ended June 30, 2006 to \$774,625 as compared with \$421,977 for the first quarter of 2006. The increase in research and development expenditures for the second quarter of 2006 is primarily due to the commencement of the Phase I clinical trial for PRX302 for the treatment of localized prostate cancer.

Research and development expenses for the six months ended June 30, 2006 were \$1,196,602 compared with \$1,708,956 for the same period last year. The majority of the research and development expenditures for the first six months of 2006 were related to the start up of the Phase I clinical trial for PRX302 and the treatment expenses for the first few patients. Patient enrolment commenced on May 2, 2006 and is expected to be completed by the end of 2006. In contrast, the majority of the expenditures in 2005 were related to the preclinical animal studies and GMP manufacturing of PRX302. Research expenditures for the three and six months ended June 30, 2006 were offset by IRAP funding of \$21,030 and \$134,365 respectively.

General and Administrative

General and administrative expenditures increased to \$530,061 in the quarter ended June 30, 2006 compared with \$420,019 for the first quarter of 2006. The increase in general and administrative expenses for the second quarter of 2006 is primarily due to costs associated with the AGM held in June 2006, additional travel and legal expenses related to the acquisition of the INxinTM program and 2005 annual report costs.

General and administrative expenditures for the six months ended June 30, 2006 were \$976,903 compared with \$603,634 for the same period last year. The increase in general and administrative expenses is primarily due to the change in management in 2005 and additional employees hired to support the Company's programs and business development activities. The

Company also incurred additional legal, travel and consulting fees to support the transition from a preclinical stage company to a clinical stage company and to acquire the INxin™ program.

Stock-based Compensation

Stock-based compensation for the three months ended June 30, 2006 amounted to \$146,824, compared with \$136,459 for the second quarter of 2005, and \$285,604 for the six months ended June 30, 2006 compared with \$200,682 for the same period last year. The increase in stock-based compensation relates to stock options granted to new employees during 2005 and 2006 as well as additional stock options granted to existing employees and directors in July 2005 and March 2006.

Other Income and Expenses

The Company earned \$35,750 in interest for the three months ended June 30, 2006, compared with \$16,182 for the second quarter of 2005, and \$69,534 for the six months ended June 30, 2006 compared with \$38,360 for the same period last year. The increase in interest income is a result of higher interest rates and higher average amounts held in interest bearing accounts.

The Company incurred a foreign exchange loss on the US dollar denominated cash and cash equivalents and accounts payable balances of \$60,380 for the three months ended June 30, 2006, compared with \$17,602 for the second quarter of 2005, and \$33,558 for the six months ended June 30, 2006 compared with \$18,657 for the same period last year.

Summary of Quarterly Results

	Three months ended June 30, 2006	Three months ended March 31, 2006	Three months ended December 31, 2005	Three months ended September 30, 2005
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 35,750	\$ 33,783	\$ 15,079	\$ 8,895
Total expenses	\$ 1,514,123	\$ 887,020	\$ 1,582,563	\$ 1,455,246
Net loss	\$ (1,478,373)	\$ (854,824)	\$ (1,570,622)	\$ (1,447,035)
Net loss per share	\$ (0.04)	\$ (0.02)	\$ (0.05)	\$ (0.06)
	Three months ended June 30, 2005	Three months ended March 31, 2005	Three months ended December 31, 2004	Three months ended September 30, 2004
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 16,182	\$ 22,178	\$ 14,150	\$ 9,757
Total expenses	\$ 1,564,944	\$ 1,003,506	\$ 1,485,918	\$ 748,719
Net loss	\$ (1,548,762)	\$ (982,913)	\$ (1,471,768)	\$ (738,962)
Net loss per share	\$ (0.07)	\$ (0.04)	\$ (0.06)	\$ (0.03)

Share Capital

As at August 8, 2006, the Company had:

- 35,943,789 common shares issued and outstanding;
- 11,786,112 warrants to purchase common shares outstanding with an exercise price of \$0.65 per share. In conjunction with the private placement completed in November 2005, 11,743,600 warrants were issued as part of the unit offering and 42,512 warrants were issued as commission. Each warrant entitles the holder to purchase one common share for a period of 24 months from the closing of the private placement financing until November 2007, at a price of \$0.65 per share. For further details on the warrants that

were outstanding at June 30, 2006, please refer to Note 5(c) in the interim financial statements of the Company for the three and six months ended June 30, 2006.

- 3,241,535 stock options outstanding to purchase common shares of the Company, of which 1,537,605 were exercisable at a weighted average exercise price of \$0.64. Certain of these options are subject to escrow provisions in accordance with the policies of the Exchange. For further details on the options that were outstanding at June 30, 2006, please refer to Note 5(b) in the interim financial statements of the Company for the three and six months ended June 30, 2006.

Liquidity

As at June 30, 2006, the Company had cash and cash equivalents of \$3,781,399 compared with \$5,471,804 as at December 31, 2005. As at June 30, 2006, the Company had working capital of \$3,284,437 compared with \$5,166,583 as at December 31, 2005 and \$2,048,193 as at June 30, 2005. The increase in current assets compared with June 30, 2005 is primarily attributable to the non-brokered private placement of \$5,619,915, net of cash costs of \$251,885, completed in November 2005.

Based on the current business plan, including the acquisition of the INxin™ program announced on July 20, 2006, the Company anticipates that it will have sufficient funds to operate its business into Q1, 2007. 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. The Company will need to raise further capital in order to extend its research and development programs beyond Q1, 2007. There can be no assurance that the Company will be able to obtain further financing on terms that are acceptable, if at all.

Related Party Transactions

During the three and six months ended June 30, 2006, the Company incurred the following related party transactions in the normal course of operations and recorded them at the exchange amount:

- Certain directors provide finance and operational services to the Company through consulting and other agreements. During the three months ended June 30, 2006, the Company incurred consulting and operational expenses of \$79,183 (\$131,125 for the three months ended June 30, 2005) and \$156,656 for the six months ended June 30, 2006 (\$206,207 for the six months ended June 30, 2005) provided by companies with a director in common to the Company. At June 30, 2006, the amount owed to these companies was \$19,813 (June 30, 2005: \$28,176).

Critical Accounting Estimates

Stock Based Compensation

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.

Dividends

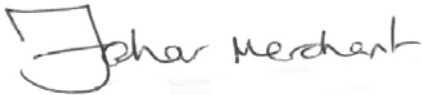
The Company has not, since its inception, declared or paid any dividends on its common shares and it does not expect to do so in the foreseeable future.

Risks and Uncertainties

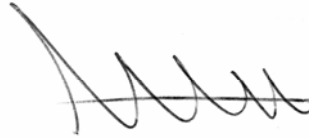
The Company is at an early stage of development and has incurred losses and will continue to incur losses in the foreseeable future. Developing new technologies will require further significant time and expense. It may be a number of years before the Company's technology begins to generate revenues, 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.

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 funds, 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 raw 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; 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 upscaling) and the need to manufacture to regulatory standards; 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 relationships with key customers and suppliers, 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. Please refer to the sections entitled "Liquidity" set out above and to the Company's Prospectus dated June 29, 2004, which can be found at www.sedar.com for a further discussion of the risks and uncertainties facing the Company.



Fahar Merchant
President & CEO



Leonard Cox
Chief Financial Officer

Dated: August 8, 2006

Protox Therapeutics Inc.
(a development stage company)

Interim Financial Statements
Second Quarter
Ended June 30, 2006

Protox Therapeutics Inc.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3 (3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Protox Therapeutics Inc.

(a development stage company)

Interim Balance Sheets

	June 30, 2006 (Unaudited)	December 31, 2005 (Audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,781,399	\$ 5,471,804
Prepaid expenses and other receivables	206,268	163,582
	3,987,667	5,635,386
Property and equipment (Note 3)	214,479	217,617
	\$ 4,202,146	\$ 5,853,003
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 358,594	\$ 166,740
Accrued liabilities	300,017	263,954
Current portion of lease obligations (Note 4)	44,619	38,109
	703,230	468,803
Long-term portion of lease obligations (Note 4)	38,502	44,781
	741,732	513,584
Shareholders' equity:		
Common shares (Note 5(a))	10,500,662	10,198,956
Common share purchase warrants (Note 5(c))	2,125,010	2,388,681
Other equity (Note 5(d))	2,189,317	1,773,160
Deficit accumulated during the development stage	(11,354,575)	(9,021,378)
	3,460,414	5,339,419
	\$ 4,202,146	\$ 5,853,003

Nature of operations and going concern (Note 1)

Commitments (Note 9)

Subsequent event (Note 10)

Approved by the Board of Directors



Jim Heppell
Director



Frank Holler
Director

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

Protox Therapeutics Inc.

(a development stage company)

Interim Statements of Operations and Deficit (unaudited)

(Unaudited)	For the three months ended June 30,		For the six months ended June 30,	
	2006	2005	2006	2005
Expenses				
Research and development	\$ 774,625	\$ 1,021,609	\$ 1,196,602	\$ 1,708,956
IRAP grant (Note 8(b))	(21,030)	-	(134,365)	-
General and administrative	530,061	368,709	976,903	603,634
Stock-based compensation (Note 5(b))	146,824	136,459	285,604	200,682
Amortization	21,571	17,927	41,150	33,884
	1,452,051	1,544,704	2,365,894	2,547,156
Other income (expenses)				
Interest income	35,750	16,182	69,534	38,360
Interest expense	(1,692)	(2,638)	(3,279)	(4,222)
Foreign exchange loss	(60,380)	(17,602)	(33,558)	(18,657)
	(26,322)	(4,058)	32,697	15,481
Loss for the period	(1,478,373)	(1,548,762)	(2,333,197)	(2,531,675)
Deficit accumulated during the development stage - beginning of period	(9,876,202)	(4,454,959)	(9,021,378)	(3,472,046)
Deficit accumulated during the development stage - end of period	\$ (11,354,575)	\$ (6,003,721)	\$ (11,354,575)	\$ (6,003,721)
Basic and diluted loss per share	\$ (0.04)	\$ (0.07)	\$ (0.06)	\$ (0.11)
Weighted average number of outstanding shares	35,943,789	23,754,148	35,910,479	23,618,564

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

Protox Therapeutics Inc.
(a development stage company)
Interim Statements of Cash Flow (unaudited)

(Unaudited)	For the three months ended June 30,		For the six months ended June 30,	
	2006	2005	2006	2005
Cash flows from operating activities				
Loss for the period	\$ (1,478,373)	\$ (1,548,762)	\$ (2,333,197)	\$ (2,531,675)
Items not affecting cash:				
Stock compensation expense (Note 5(b))	146,824	136,459	285,604	200,682
Amortization	21,571	17,927	41,150	33,884
Change in non-cash working capital:				
Investment tax credits receivable	-	71,120	-	71,120
Prepaid expenses and other receivables	9,754	(7,142)	(42,686)	47,817
Accounts payable	194,454	46,771	191,854	(28,598)
Accrued liabilities	108,125	(16,091)	36,063	(61,210)
	(997,645)	(1,299,718)	(1,821,212)	(2,267,980)
Cash flows from investing activities				
Purchase of property and equipment	(24,401)	(3,526)	(38,012)	(16,359)
	(24,401)	(3,526)	(38,012)	(16,359)
Cash flows from financing activities				
Issuance of common shares on exercise of warrants (Note 5)	-	-	164,738	11,595
Issuance of common shares on exercise of options (Note 5)	-	-	3,850	-
Capital lease financing (Note 4)	19,897	-	19,897	-
Capital lease payments	(10,416)	(8,725)	(19,666)	(14,448)
	9,481	(8,725)	168,819	(2,853)
Decrease in cash and cash equivalents	(1,012,565)	(1,311,969)	(1,690,405)	(2,287,192)
Cash and cash equivalents - beginning of period	4,793,964	3,936,267	5,471,804	4,911,490
Cash and cash equivalents - end of period	\$ 3,781,399	\$ 2,624,298	\$ 3,781,399	\$ 2,624,298
Supplemental cash flow information				
Interest received	\$ 49,754	\$ 11,788	\$ 71,046	\$ 24,800
Interest paid	1,693	-	3,279	-
Transfer of trade payable to capital lease	-	-	-	109,584
Issuance of shares for license fee liability	-	-	-	184,091

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

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

1. Nature of operations and going concern

The Company

Protox Therapeutics Inc. (Protox or the Company) is incorporated under the Company Act of British Columbia. The Company began operations on January 11, 2002. The Company's primary focus is the development of targeted therapeutics for cancer and other proliferative diseases through the engineering of naturally occurring toxins. The Company is considered to be in the early development stage, as most of its efforts have been devoted to basic research and development, raising capital and recruitment of personnel.

Going concern

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes the realization of assets and discharge of liabilities in the normal course of business. The Company has incurred losses from operations since inception and its ability to continue operations on a going concern basis is dependent upon obtaining additional financing, completing development and commercialization of its products and generating cash from operations. There is no assurance the Company will be successful in achieving these objectives. The Company anticipates that it will have sufficient funds to operate its business for approximately the next six months, based on its current business plan. The Company is actively seeking additional funding to support operations beyond 2006. These financial statements do not give effect to any adjustments that would be necessary should the Company be unable to continue as a going concern.

2. Significant accounting policies

Interim statements

The accompanying unaudited financial statements are prepared in accordance with Canadian generally accepted accounting principles 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, 2005. 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, 2005. When necessary, the financial statements include amounts based on informed estimates and best judgments of management. The results of operations for the interim periods reported are not necessarily indicative of results to be expected for the year.

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

3. Property and equipment

Property and equipment consist of the following:

June 30, 2006 (Unaudited)	Cost	Accumulated amortization	Net book value
Computer hardware and software	\$ 73,827	\$ 26,604	\$ 47,223
Laboratory equipment	220,816	89,398	131,418
Furniture and fixtures	17,857	6,414	11,443
Leasehold improvements	36,593	12,198	24,395
	<u>\$ 349,093</u>	<u>\$ 134,614</u>	<u>\$ 214,479</u>

December 31, 2005 (Audited)	Cost	Accumulated amortization	Net book value
Computer hardware and software	\$ 40,642	\$ 16,498	\$ 24,144
Laboratory equipment	219,811	63,678	156,133
Furniture and fixtures	14,035	4,750	9,285
Leasehold improvements	36,593	8,538	28,055
	<u>\$ 311,081</u>	<u>\$ 93,464</u>	<u>\$ 217,617</u>

4. Leases payable

In January 2005, the Company entered into a 36 month capital lease arrangement to finance certain laboratory equipment purchased in 2004 costing a total \$115,307. In April 2006, the Company entered into a 54 month capital lease arrangement to finance certain office equipment costing a total \$19,897.

	June 30, 2006 (Unaudited)	December 31, 2005 (Audited)
Capital equipment leases	\$ 83,121	\$ 82,890
Less current portion	44,619	38,109
Long-term portion	<u>\$ 38,502</u>	<u>\$ 44,781</u>

Future minimum lease payments for these capital leases are as follows:

Fiscal year	Amount (in dollars)
2006	\$ 24,120
2007	48,242
2008 onwards	17,340
Total lease payments	89,702
Less interest portion	6,581
Capital leases payable	<u>\$ 83,121</u>

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

5. Shareholders' equity

(a) Common shares

Authorized: unlimited (2005: unlimited) common shares without par value

Issued: 35,943,789 (2005: 35,575,814) common shares without par value

	Number of shares	Amount (in dollars)
Balance at December 31, 2005	35,575,814	\$ 10,198,956
Issuance of common shares on exercise of options	38,500	26,950
Issuance of common shares on exercise of warrants	329,475	274,756
Balance at June 30, 2006	35,943,789	\$ 10,500,662

(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 the greater of 10% of the issued and outstanding common shares or 4,000,000 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 four years and an exercise period of up to five years.

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

	Number of options	Weighted average exercise price
Balance outstanding - December 31, 2005	2,740,345	\$ 0.79
Options granted	720,000	0.52
Options cancelled	(109,103)	1.00
Options exercised	(38,500)	0.10
Options expired	(76,207)	1.00
Balance outstanding - June 30, 2006	3,236,535	\$ 0.72

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

5. Shareholders' equity (continued)

The following table summarizes information about stock options for employees, directors, officers, scientific advisory board members and consultants outstanding at June 30, 2006:

Exercise price	Number outstanding	Options outstanding		Options exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price	Number	Weighted average exercise price
\$ 0.10	346,500	2.1	\$ 0.10	346,500	\$ 0.10
0.50	473,535	2.3	0.50	473,535	0.50
1.00	1,696,500	3.6	1.00	717,570	1.00
0.52	705,000	4.7	0.52	-	0.52
0.60	15,000	4.9	0.60	-	0.60
	3,236,535	3.5	\$ 0.72	1,537,605	\$ 0.64

On March 20, 2006, the Company granted 670,000 options to employees and officers and 35,000 options to non-employees with an exercise price of \$0.52. On May 15, 2006, the Company granted 15,000 options to employees with an exercise price of \$0.60.

The fair value of options granted to employees and directors during the six months ended June 30, 2006 was estimated using the Black-Scholes option pricing model with the following weighted average assumptions; expected life of the options – 2.67 years, volatility 114%, dividend yield 0%, and risk-free interest rate 3.95%.

Stock-based compensation expense for the three months ended June 30, 2006 was \$146,824 (\$136,459 for the three months ended June 30, 2005) and for the six months ended June 30, 2006 was \$285,604 (\$200,682 for the six months ended June 30, 2005).

(c) Warrants

At June 30, 2006, the Company had warrants to purchase common shares outstanding as follows:

Date:	Description:	Number outstanding:	Weighted Exercise price:	Fair Value at date of grant:
	Balance at December 31, 2005	12,503,077	\$ 0.66	\$ 2,388,681
January 2006	Ascribed value of exercised warrants	(329,475)	0.50	(110,018)
January 2006	Ascribed value of expired warrants	(387,490)	0.96	(153,653)
	Balance at June 30, 2006	11,786,112	\$ 0.65	\$ 2,125,010

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

5. Shareholders' equity (continued)

In January, 2006, 329,475 warrants with an exercise price of \$0.50 were exercised for proceeds of \$164,738. A total of 387,490 warrants expired in January, 2006; 29,250 warrants with an exercise price of \$0.50 and 358,240 warrants with an exercise price of \$1.00. As such, the Company reclassified the warrant value of the expired warrants to other equity in the amount of \$153,653.

(d) Other equity

At June 30, 2006 the Company had other equity recorded as follows:

	Amount (in dollars)
Balance at December 31, 2005	\$ 1,773,160
Issuance of common shares on exercise of options	(23,100)
Expiration of warrants	153,653
Stock compensation expense	285,604
Balance at June 30, 2006	\$ 2,189,317

6. Related party transactions

During the period ended June 30, 2006, the Company incurred the following related party transactions in the normal course of operations and recorded them at the exchange amount:

- Certain directors provide finance and operational services to the Company through consulting and other agreements. During the three month period ended June 30, 2006, the Company incurred consulting and operational expenses of \$79,183 (\$131,125 for the three months ended June 30, 2005) and \$156,656 for the six months ended June 30, 2006 (\$206,207 for the six months ended June 30, 2005) provided by companies with a director in common to the Company. At June 30, 2006, the amount owed to these companies was \$19,813 (June 30, 2005: \$28,176).

7. 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 targeted therapeutics and operates in one geographic area, being Canada. All of the Company's assets are located in Canada.

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

8. Agreements

(a) Clinical trial agreements

On October 26, 2005, Protox entered into a clinical trials agreement with Scott & White, to conduct a Phase I clinical study of PRX302 for the treatment of localized, recurrent prostate cancer. On January 16, 2006, the Company received clearance from the United States Food and Drug Administration to commence Phase I clinical trials.

On May 24, 2006, Protox entered into a clinical trials agreement with The University of Texas M.D. Anderson Cancer Center, to conduct a Phase I clinical study of PRX302 for the treatment of localized, recurrent prostate cancer.

On June 20, 2006, Protox entered into a clinical trials agreement with Fletcher Allen Health Care Inc. to conduct a Phase I clinical study of PRX302 for the treatment of localized, recurrent prostate cancer.

(b) IRAP funding agreement

On June 1, 2005 the Company entered into a funding agreement with the National Research Council (NRC) of up to \$340,000 from the Industrial Research Assistance Program (IRAP). The NRC committed this money to the Company to support its development of novel cancer therapeutics. The contribution is non-repayable. On March 10, 2006 the funding agreement was amended to take into account the change in research activities. The amended agreement provides for a maximum funding of \$140,000. The Company has claimed \$134,365 for the six months ended June 30, 2006 (nil for the six months ended June 30, 2005) and \$21,030 for the three months ended June 30, 2006 (nil for the three months ended June 30, 2005).

9. Commitments

(a) Laboratory facilities

The Company signed a three-year lease agreement for laboratory facilities commencing January 1, 2005. Minimum payments for the remainder of 2006 and for 2007 are as follows:

	Amount (in dollars)
2006	\$ 6,520
2007	9,780
	<u>\$ 16,300</u>

The lease agreement includes a termination option at the end of the first and second years subject to a penalty of \$14,109 and \$7,331, respectively.

(b) Equipment leases

In January 2005, the Company entered into a 36 month capital lease arrangement to finance certain laboratory equipment purchased in 2004 costing a total \$115,307 (Note 4). In April 2006, the Company entered into a 54 month capital lease arrangement to finance certain office equipment costing a total \$19,897 (Note 4).

Protox Therapeutics Inc.

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Notes to the Interim Financial Statements (unaudited)

9. Commitments (continued)

(c) Office facilities

On April 1, 2006, the Company entered into a 5 year lease agreement for office facilities. Future minimum commitments are as follows:

	Amount (in dollars)
2006	\$ 37,991
2007	75,983
2008	75,983
2009 onwards	170,962
	<u>\$ 360,919</u>

10. Subsequent event

On July 20, 2006, the Company acquired a Phase II clinical stage program for the treatment of cancer from Neurocrine Biosciences Inc. and the United States Public Health Service (PHS). PRX321, formerly known as NBI-3001, is a targeted therapeutic toxin in which a cytokine, interleukin-4 (IL-4), is linked to a *Pseudomonas* exotoxin, a potent substance that can destroy cancer cells. The PRX321 program was acquired by Protox in two separate transactions. In the first transaction, Protox obtained exclusive worldwide rights to IL-4 fusion toxin technology (INxin™) from PHS. In the second transaction, regulatory and product assets were purchased from Neurocrine in order to facilitate the continued development of PRX321. The assets purchased from Neurocrine included two Investigational New Drug applications, Fast Track Designation and Orphan Drug Status, as well as cGMP batches of PRX321 that may potentially be used in future clinical trials.

Protox has committed to pay PHS and Neurocrine, for the license and corresponding assets, up to US\$2 million over the next three years. In addition, Protox will pay PHS up to US\$4 million in future milestone payments (based on the compound receiving FDA approval for at least three indications), as well as royalties on commercial sales.