

Protox

THERAPEUTICS

Management Discussion and Analysis Quarter Ended September 30, 2006

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management discussion and analysis has been prepared as of November 29, 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 nine months ended September 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 Prottox Therapeutics Inc. (Prottox 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

Prottox Therapeutics Inc. is a Canadian biotechnology company focused on the development and commercialization of targeted therapeutics derived from naturally occurring proteins for the treatment of cancer and other proliferative diseases. Prottox is advancing a pipeline of clinical-stage product candidates developed from its PORxin™ and INxin™ technology platforms. Prottox's lead drugs currently in clinical development include PRX321 for primary brain cancer (glioblastoma multiforme and astrocytoma), renal cell carcinoma and non-small cell lung cancer, and PRX302 for the treatment of localized prostate cancer.

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. PRX302, our lead drug candidate derived from the PORxin™ technology platform, is currently in Phase I clinical trials for localized recurrent prostate cancer. Patient enrolment for the Phase I trial commenced in the second quarter of 2006 and enrollment is expected to be completed in Q1, 2007.

PRX302 is also being developed for the treatment of benign prostatic hyperplasia (BPH), more commonly known as an enlarged prostate. In September 2006, the Company submitted a Clinical Trial Application (CTA) to Health Canada to commence a Phase I clinical trial with PRX302 for the treatment of BPH and the CTA was approved by Health Canada on October 11, 2006.

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 complimentary targeted toxin programs and fall directly within our core areas of expertise. INxin™ substantially expands our clinical pipeline targeting serious indications such as brain, prostate, kidney, and lung cancers that have large unmet medical needs. The acquisition of INxin™ also provides us with encouraging human clinical data from 86 cancer patients, a strengthened intellectual property portfolio of 14 patents issued worldwide and a technology which is supported by over 50 peer-reviewed scientific publications.

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. 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 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 hematological tumours.

PRX321 has received both Fast Track Designation and Orphan Drug Status 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 Status provides a number of benefits including seven years of market exclusivity.

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. (Neurocrine) and the United States Public Health Service (PHS).

- M. D. Anderson Cancer Center, The University of Vermont and Urology San Antonio joined lead center Scott & White in the Phase I prostate cancer study using PRX302.
- On September 21, 2006, the Company submitted a Clinical Trial Application (CTA) to Health Canada for the treatment of benign prostatic hyperplasia (BPH), a condition commonly known as enlarged prostate, using PRX302.
- On October 11, 2006, the Company received approval from Health Canada to initiate a Phase I human clinical trial of PRX302 to treat adult men with BPH, or enlarged prostates.
- On November 29, 2006, the Company completed a private placement of 18,349,500 Units at \$0.50 per Unit for total gross proceeds of \$9,174,750. Each Unit comprised one common share and one-half of one warrant, with each whole warrant exercisable at \$0.65 within 24 months of the closing date. The placement was co-led by Jennings Capital Inc. and Canaccord Capital Corporation.

Acquisition of INxin Program

The INxin program was acquired in two separate transactions on July 20, 2006. In the first transaction, Protox obtained exclusive worldwide rights to IL-4 fusion toxin technology from PHS. In the second transaction, regulatory and product assets were purchased from Neurocrine. The patents and technology rights acquired from PHS and Neurocrine have been capitalized as intangible assets at a cost of \$1,185,688. These intangible assets are amortized on a straight line basis over seven years.

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 \$12.7 million to September 30, 2006.

The loss for the three months ended September 30, 2006 of \$1,351,490 (\$0.04 per share) was 7% lower compared with the loss of \$1,447,035 (\$0.06 per share) for the comparable period last year and 9% lower compared with the loss of \$1,478,373 (\$0.04 per share) for the three months ended June 30, 2006. The decrease in the loss for the third quarter of 2006 compared with the second quarter of 2006 is attributable to the lower general and administration costs whereas the decrease in loss compared with the comparable period last year is primarily attributable to the lower research and development costs.

The loss for the nine months ended September 30, 2006 of \$3,684,687 (\$0.10 per share) was 7% lower compared with the loss of \$3,978,710 (\$0.17 per share) for the same period last year. The decrease in net loss for the nine months ended September 30, 2006 compared with the same period last year is primarily due to the transition of PRX302 from preclinical research to human clinical trials. The preclinical and manufacturing costs for PRX302 incurred during the nine months ended September 30, 2005 were significantly higher than the research and development costs associated with the Phase I clinical study for PRX302 incurred during the nine months ended September 30, 2006.

Research and Development

Research and development expenses of \$851,924 for the three months ended September 30, 2006 increased by 10% compared with \$774,625 for the second quarter of 2006. The increase in research and development expenditures for the third quarter of 2006 is primarily due to the Phase I clinical trial costs for PRX302 for the treatment of localized prostate cancer, which commenced in Q2, 2006, and the costs associated with the acquisition of the INxin™ program.

Research and development expenses of \$2,048,526 for the nine months ended September 30, 2006 were 22% lower compared with \$2,633,752 for the same period last year. The majority of the research and development expenditures for the first nine months of 2006 were related to the Phase I clinical trial for PRX302 for the treatment of localized prostate cancer. Patient enrolment commenced in Q2, 2006 and is expected to be completed in Q1, 2007. In contrast, the majority of the expenditures in 2005 were related to the preclinical animal studies and GMP manufacturing of PRX302. The research and development expenditures for the nine months ended September 30, 2006 also included \$41,883 associated with the amortization of the intangible assets acquired from Neurocrine and PHS on July 20, 2006.

Research expenditures for the three and nine months ended September 30, 2006 were offset by government funding of \$12,820 and \$147,185 respectively.

General and Administrative

General and administrative expenditures of \$409,656 for the three months ended September 30, 2006 are 10% higher compared with the same period last year and 23% lower compared to \$530,061 for the second quarter of 2006. The increase compared with the three months ended September 30, 2005 is due to higher travel and due diligence costs associated with the INxin acquisition. The decrease compared with the second quarter of 2006 is due to lower legal expenses and costs associated with the AGM and annual report, which were completed in the second quarter of 2006.

General and administrative expenditures of \$1,386,559 for the nine months ended September 30, 2006 were 43% higher compared with \$971,556 for the same period last year. The increase in general and administrative expenses is primarily due to additional business development expenses, travel and due diligence costs associated with the INxin acquisition and additional employees hired to support the Company's programs.

Stock-based Compensation

Stock-based compensation for the three months ended September 30, 2006 amounted to \$103,069, compared with \$149,575 for the same period last year, and \$388,673 for the nine months ended September 30, 2006 compared with \$350,257 for the same period last year. The increase in stock-based compensation for the nine months ended September 30, 2006 compared with the same period last year relates to stock options granted to new employees as well as additional stock options granted to existing employees and directors.

Other Income and Expenses

The Company earned \$32,991 in interest for the three months ended September 30, 2006, compared with \$8,895 for the third quarter of 2005, and \$102,525 for the nine months ended

September 30, 2006 compared with \$47,255 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 of \$8,363 on the US dollar denominated cash and cash equivalents and accounts payable balances for the three months ended September 30, 2006, compared with a gain of \$983 for the same period last year, and a loss of \$41,921 for the nine months ended September 30, 2006 compared with a loss of \$17,674 for the same period last year.

Summary of Quarterly Results

	Three months ended September 30, 2006	Three months ended June 30, 2006	Three months ended March 31, 2006	Three months ended December 31, 2005
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 32,991	\$ 35,750	\$ 33,783	\$ 15,079
Total expenses	\$ 1,384,481	\$ 1,514,123	\$ 888,607	\$ 1,582,563
Net loss	\$ (1,351,490)	\$ (1,478,373)	\$ (854,824)	\$ (1,570,622)
Net loss per share	\$ (0.04)	\$ (0.04)	\$ (0.02)	\$ (0.05)
	Three months ended September 30, 2005	Three months ended June 30, 2005	Three months ended March 31, 2005	Three months ended December 31, 2004
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 8,895	\$ 16,182	\$ 22,178	\$ 14,150
Total expenses	\$ 1,455,930	\$ 1,564,944	\$ 1,003,506	\$ 1,485,918
Net loss	\$ (1,447,035)	\$ (1,548,762)	\$ (982,913)	\$ (1,471,768)
Net loss per share	\$ (0.06)	\$ (0.07)	\$ (0.04)	\$ (0.06)

Share Capital

As at November 29, 2006, the Company had 54,293,289 common shares issued and outstanding. The total shares issued and outstanding includes 18,349,500 common shares issued as part of a private placement of Units completed on November 29, 2006 for total gross proceeds of \$9,174,750. Each Unit comprised one common share and one-half of one warrant.

As at November 29, 2006, the Company had 22,142,739 warrants to purchase common shares outstanding with an exercise price of \$0.65 per share. The total warrants outstanding includes 9,174,750 warrants issued as part of a private placement of Units completed on November 29, 2006 plus 1,061,465 warrants issued to the agents (collectively the "2006 Warrants"). Each 2006 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 29, 2008, at a price of \$0.65 per share.

As at November 29, 2006, the Company had 3,311,535 stock options outstanding to purchase common shares of the Company, of which 1,687,247 were exercisable at a weighted average exercise price of \$0.66. Certain of these options are subject to escrow provisions in accordance with the policies of the Exchange.

For further details on the common shares, warrants and stock options that were outstanding at September 30, 2006, please refer to Note 6 in the interim financial statements of the Company for the three and nine months ended September 30, 2006.

Liquidity

As at September 30, 2006, the Company had cash and cash equivalents of \$2,283,353 compared with \$5,471,804 as at December 31, 2005. As at September 30, 2006, the Company had working capital of \$886,564 compared with \$5,166,583 as at December 31, 2005 and \$776,864 as at September 30, 2005. The decrease in working capital compared with December 31, 2005 is primarily attributable to the \$2,105,860 cash utilized in operations for the nine months ended September 30, 2006 and the increase in accounts payable as a result of the acquisition of the intangible INxinTM assets from Neurocrine and PHS.

On November 29, 2006, the Company completed a private placement of 18,349,500 Units at \$0.50 per Unit for gross proceeds of \$9,174,750. Each Unit comprised one common share of Protox and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one common share of Protox within 24 months of the date of closing at a price of \$0.65 per share.

Based on the current business plan and the closing of the \$9,174,750 private placement financing on November 29, 2006, the Company anticipates that it will have sufficient funds to operate its business into Q1, 2008. 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, 2008. 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 nine months ended September 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 September 30, 2006, the Company incurred consulting and operational expenses of \$58,565 (\$143,591 for the three months ended September 30, 2005) and \$215,221 for the nine months ended September 30, 2006 (\$322,244 for the nine months ended September 30, 2005) provided by companies with a director in common to the Company. At September 30, 2006, there were no amounts owed to these companies (September 30, 2005: \$97,290).

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

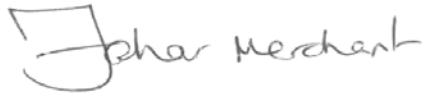
The Company has not, since its inception, declared or paid any dividends on its common shares and it does not expect to do so in the foreseeable future.

Risks and Uncertainties

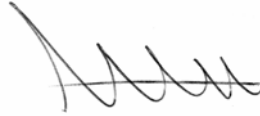
The Company is at an early stage of development and has incurred losses and will continue to incur losses in the foreseeable future. Developing new technologies will require further significant time and expense. It may be a number of years before the Company's technology begins to generate revenues, 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: November 29, 2006

Protox Therapeutics Inc.
(a development stage company)

Interim Financial Statements
Third Quarter
Ended September 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

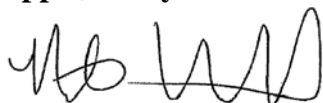
	September 30, 2006 (Unaudited)	December 31, 2005 (Audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,283,353	\$ 5,471,804
Prepaid expenses and other receivables	267,084	163,582
	2,550,437	5,635,386
Property and equipment (Note 3)	208,731	217,617
Intangible assets (Note 4)	1,143,805	-
	\$ 3,902,973	\$ 5,853,003
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 1,319,503	\$ 166,740
Accrued liabilities	298,971	263,954
Current portion of lease obligations (Note 5)	45,399	38,109
	1,663,873	468,803
Long-term portion of lease obligations (Note 5)	27,107	44,781
	1,690,980	513,584
Shareholders' equity:		
Common shares (Note 6(a))	10,500,662	10,198,956
Common share purchase warrants (Note 6(c))	2,125,010	2,388,681
Other equity (Note 6(d))	2,292,386	1,773,160
Deficit accumulated during the development stage	(12,706,065)	(9,021,378)
	2,211,993	5,339,419
	\$ 3,902,973	\$ 5,853,003

Nature of operations and going concern (Note 1)

Commitments (Note 10)

Subsequent event (Note 11)

Approved by the Board of Directors



Nitin Kaushal
Chairman of the Audit Committee



Frank Holler
Chairman of the Board

Protox Therapeutics Inc.

(a development stage company)

Interim Statements of Operations and Deficit (unaudited)

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

(Unaudited)	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
Expenses				
Research and development	\$ 851,924	\$ 920,203	\$ 2,048,526	\$ 2,633,752
Grants (Note 9)	(12,820)	(4,500)	(147,185)	(4,500)
General and administrative	409,656	372,515	1,386,559	971,556
Stock-based compensation (Note 6)	103,069	149,575	388,673	350,257
Amortization	22,843	18,436	63,993	52,320
	1,374,672	1,456,229	3,740,566	4,003,385
Other income (expenses)				
Interest income	32,991	8,895	102,525	47,255
Interest expense	(1,446)	(684)	(4,725)	(4,906)
Foreign exchange (loss) gain	(8,363)	983	(41,921)	(17,674)
	23,182	9,194	55,879	24,675
Loss for the period	(1,351,490)	(1,447,035)	(3,684,687)	(3,978,710)
Deficit accumulated during the development stage - beginning of period	(11,354,575)	(6,003,721)	(9,021,378)	(3,472,046)
Deficit accumulated during the development stage - end of period	\$ (12,706,065)	\$ (7,450,756)	\$ (12,706,065)	\$ (7,450,756)
Basic and diluted loss per share	\$ (0.04)	\$ (0.06)	\$ (0.10)	\$ (0.17)
Weighted average number of outstanding shares	35,943,789	23,795,840	35,921,704	23,678,305

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 September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
Cash flows from operating activities				
Loss for the period	\$ (1,351,490)	\$ (1,447,035)	\$ (3,684,687)	\$ (3,978,710)
Items not affecting cash:				
Stock compensation expense (Note 6 (b))	103,069	149,575	388,673	350,257
Amortization of intangible assets (Note 4)	41,883	-	41,883	-
Amortization of property and equipment	22,843	18,436	63,993	52,320
Change in non-cash working capital:				
Investment tax credits receivable	-	-	-	71,120
Prepaid expenses and other receivables	(60,816)	(47,286)	(103,502)	531
Accounts payable	960,909	198,801	1,152,763	108,993
Accrued liabilities	(1,046)	-	35,017	-
	(284,648)	(1,127,509)	(2,105,860)	(3,395,489)
Cash flows from investing activities				
Purchase of property and equipment	(17,095)	(6,996)	(55,107)	(23,355)
Acquisition of intangible assets	(1,185,688)	-	(1,185,688)	-
	(1,202,783)	(6,996)	(1,240,795)	(23,355)
Cash flows from financing activities				
Issuance of common shares on exercise of warrants (Note 6)	-	-	164,738	11,595
Issuance of common shares on exercise of options (Note 6)	-	24,310	3,850	24,310
Capital lease financing (Note 5)	-	-	19,897	-
Capital lease payments	(10,615)	(10,341)	(30,281)	(24,789)
	(10,615)	13,969	158,204	11,116
Decrease in cash and cash equivalents	(1,498,046)	(1,120,536)	(3,188,451)	(3,407,728)
Cash and cash equivalents - beginning of period	3,781,399	2,624,298	5,471,804	4,911,490
Cash and cash equivalents - end of period	\$ 2,283,353	\$ 1,503,762	\$ 2,283,353	\$ 1,503,762
Supplemental cash flow information				
Interest received	\$ 8,681	\$ 5,431	\$ 89,422	\$ 30,311
Interest paid	1,446	-	4,725	-
Transfer of trade payable to capital lease obligation	-	-	-	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. 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

(a) 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.

(b) 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 assets. 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.

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:

September 30, 2006 (Unaudited)	Cost	Accumulated amortization	Net book value
Computer hardware and software	\$ 90,391	\$ 33,836	\$ 56,555
Laboratory equipment	220,816	102,269	118,547
Furniture and fixtures	18,388	7,325	11,063
Leasehold improvements	36,593	14,027	22,566
	<u>\$ 366,188</u>	<u>\$ 157,457</u>	<u>\$ 208,731</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. Intangible assets

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). The program was acquired in two separate transactions. In the first transaction, Protox obtained exclusive worldwide rights to IL-4 fusion toxin technology (INxinTM) from PHS. In the second transaction, regulatory and product assets were purchased from Neurocrine. The patents and technology rights acquired from PHS and Neurocrine have been capitalized at cost. These intangible assets are amortized on a straight line basis over seven years.

September 30, 2006	Cost	Accumulated amortization	Net book value
Patents and technology rights	\$ 1,185,688	\$ 41,883	\$ 1,143,805

December 31, 2005	Cost	Accumulated amortization	Net book value
Patents and technology rights	\$ -	\$ -	\$ -

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

5. 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.

	September 30, 2006 (Unaudited)	December 31, 2005 (Audited)
Capital equipment leases	\$ 72,506	\$ 82,890
Less current portion	45,399	38,109
<u>Long-term portion</u>	<u>\$ 27,107</u>	<u>\$ 44,781</u>

Future minimum lease payments are as follows:

Fiscal year	Amount (in dollars)
2006	\$ 12,059
2007	48,242
2008 onwards	17,340
Total lease payments	77,641
Less interest portion	5,135
<u>Capital leases payable</u>	<u>\$ 72,506</u>

6. 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
<u>Balance at September 30, 2006</u>	<u>35,943,789</u>	<u>\$ 10,500,662</u>

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

6. Shareholders' 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 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	775,000	0.52
Options cancelled	(119,103)	0.96
Options exercised	(38,500)	0.10
Options expired	(76,207)	1.00
Balance outstanding - September 30, 2006	3,281,535	\$ 0.72

The following table summarizes information about stock options outstanding at September 30, 2006 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	Weighted average exercise price
\$ 0.10	346,500	1.8	\$ 0.10	346,500	\$ 0.10
0.50	473,535	2.1	0.50	473,535	0.50
0.51 - 0.99	765,000	4.5	0.52	50,000	0.52
1.00	1,696,500	3.4	1.00	817,212	1.00
	3,281,535	3.3	\$ 0.72	1,687,247	\$ 0.66

The Company granted 55,000 stock options to employees during the three months ended September 30, 2006 with an average exercise price of \$0.54. The Company granted 740,000 stock options to employees and 35,000 stock options to non-employees during the nine months ended September 30, 2006 with an average exercise price of \$0.52.

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

6. Shareholders' equity (continued)

(b) Stock options (continued)

The fair value of options granted to employees and directors during the nine months ended September 30, 2006 was estimated using the Black-Scholes option pricing model with the following weighted average assumptions; expected life of the options – 2.62 years, volatility 112%, dividend yield 0%, and risk-free interest rate 3.96%.

Stock-based compensation expense for the three months ended September 30, 2006 was \$103,069 (\$149,575 for the three months ended September 30, 2005) and for nine months ended September 30, 2006 was \$388,673 (\$350,257 for the nine months ended September 30, 2005).

(c) Warrants

At September 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 September 30, 2006	11,786,112	\$ 0.65	\$ 2,125,010

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 September 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	388,673
Balance at September 30, 2006	\$ 2,292,386

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

7. Related party transactions

During the period ended September 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 September 30, 2006, the Company incurred consulting and operational expenses of \$58,565 (\$143,591 for the three months ended September 30, 2005) and \$215,221 for the nine months ended September 30, 2006 (\$322,244 for the nine months ended September 30, 2005) provided by companies with a director in common to the Company. At September 30, 2006, there were no amounts owed to these companies (September 30, 2005: \$97,290).

8. 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.

9. Agreements

(a) PRX302 clinical trial agreements

The Company has entered into the following clinical trial agreements to conduct a Phase I clinical study of PRX302 for the treatment of localized, recurrent prostate cancer:

- Scott & White Memorial Hospital, effective October 26, 2005
- The University of Texas M.D. Anderson Cancer Center, effective May 24, 2006
- Fletcher Allen Health Care Inc., effective June 20, 2006
- Urology San Antonio, effective August 14, 2006

(b) INxin license and acquisition

On July 20, 2006, the Company acquired a Phase II clinical stage program for the treatment of cancer from Neurocrine Biosciences Inc. (NBI) and the United States Public Health Service (PHS). The program's lead drug candidate, 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 program was acquired in two separate transactions. In the first transaction, Protox obtained exclusive worldwide rights to IL-4 fusion toxin technology (INxinTM) from PHS. In the second transaction, regulatory and product assets were purchased from NBI in order to facilitate the continued development of PRX321. The assets purchased from NBI 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 Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

9. Agreements (continued)

(c) Government funding

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 and extended to July 6, 2006. The amended agreement provided for a maximum funding of \$140,000. The Company claimed a total of \$133,685 under this agreement.

The Company has also received funding of \$13,500 under the National Sciences and Engineering Research Council Program during the nine months ended September 30, 2006.

10. Commitments

(a) Laboratory facilities

In December, 2004, the Company signed a three-year lease agreement commencing January 1, 2005 for laboratory facilities. Minimum payments for the next two years to the end of the lease are as follows:

	Amount (in dollars)
2006	\$ 3,260
2007	13,040
	<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 5).

In April 2006, the Company entered into a 54 month capital lease arrangement to finance certain office equipment costing a total \$19,897 (Note 5).

Protox Therapeutics Inc.

(a development stage company)

Notes to the Interim Financial Statements (unaudited)

10. 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	\$ 18,996
2007	75,983
2008	75,983
2009 onwards	170,962
	<u>\$ 341,924</u>

(d) INxin license and acquisition

On July 20, 2006, the Company acquired a Phase II clinical stage program for the treatment of cancer from Neurocrine Biosciences Inc. (NBI) and the United States Public Health Service (PHS). Protox has committed to pay NBI and PHS up to U.S.\$2 million over three years for the INxin license, regulatory assets and product related assets. In addition, Protox will pay PHS up to U.S.\$4 million in future milestone payments (based on the compound receiving FDA approval for at least three indications), as well as low single digit royalties on commercial sales.

11. Subsequent event

Private placement financing

On November 29, 2006, the Company completed a private placement of 18,349,500 Units at a price of \$0.50 per Unit for gross proceeds of \$9,174,750. Each Unit comprises one common share and one-half of one common share purchase warrant. Each whole warrant enables the holder to purchase one common share at a price of \$0.65 for a period of 24 months from the closing of the private placement.