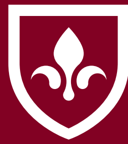

Bellus
HEALTH

BELLUS HEALTH
ANNUAL REPORT
— 2010

Certain statements contained in this document, other than statements of fact that are independently verifiable at the date hereof, may constitute forward-looking statements. Such statements, based as they are on the current expectations of management, inherently involve numerous risks and uncertainties, known and unknown, many of which are beyond BELLUS Health Inc.'s control. Such risks include but are not limited to: the ability to obtain financing immediately in the current markets, the impact of general economic conditions, general conditions in the pharmaceutical and/or nutraceutical industry, changes in the regulatory environment in the jurisdictions in which the BELLUS Health Group does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, achievement of forecasted burn rate, that actual results may vary once the final and quality-controlled verification of data and analyses has been completed, as well as other risks disclosed in public filings of BELLUS Health Inc. Consequently, actual future results may differ materially from the anticipated results expressed in the forward-looking statements. The reader should not place undue reliance, if any, on any forward-looking statements included in this document. These statements speak only as of the date made and BELLUS Health Inc. is under no obligation and disavows any intention to update or revise such statements as a result of any event, circumstances or otherwise, unless required by applicable legislation or regulation. Please see the Annual Information Form as well as registration statements and other public filings of BELLUS Health Inc. for further risk factors that might affect the BELLUS Health Group and its business.

Dear Shareholders,

The year 2010 was a busy and productive one for BELLUS Health. It was also a year of important accomplishments. As the year began, we presented shareholders with a new business plan articulated around three key components. Executing this plan has been our focal point in 2010, and I am pleased to report that our efforts delivered results.

The first component of our plan was a new business model and vision to focus on building value in early-development-stage products — the portion of the biotech-product life cycle where we believe we can generate greatest wealth — and then entering into strategic partnerships with strong industry players to further develop our products and bring them to the market. The second was a well-balanced pipeline of products striving towards scientific excellence. The third was a leaner, more efficient organizational structure.

In implementing the new business plan, we first entered into a number of strategic partnerships for our products that will deliver important value in the years to come. In the first half of 2010, we concluded a partnership for KIACTA™ with global pharmaceutical fund Celtic Therapeutics. While this partnership contributed to strengthening our financial situation in the short term, it also has a strong potential upside in the medium term, completely free of development financing risk for the Company. Later in the year, we entered into two distinct partnerships to commercialize VIVIMIND™ — one with FB Health for the Italian market and another with Advanced Orthomolecular Research for the Canadian market. These three transactions are clear examples of BELLUS Health's strategy at work.

As we diligently implemented our new business model, we continued to make progress on the promising products in our pipeline. Conversely, and as a result of our rigorous evaluation process, we discontinued the NC-503 (eprodisate) development program for the treatment of diabetes when the phase II clinical study results demonstrated that this product candidate did not meet our standards of excellence. We are committing our financial and human resources to the products we believe have high potential for success:

- KIACTA™ – Along with its partner Celtic Therapeutics, the Company initiated a global confirmatory phase III clinical study for this investigational product candidate being developed for the treatment of amyloid A amyloidosis. Celtic Therapeutics is assuming all costs related to the confirmatory study, which is the last key step before applications for regulatory approval for KIACTA™ can be filed. We estimate that the study will be completed in 2014.
- VIVIMIND™ – Health Canada issued a Natural Health Product Number for this patented natural health product that has been shown to support memory, thereby granting formal authorization for sale in Canada. Similarly to what has been achieved in the Italian and Canadian markets, we continue to actively pursue arrangements to distribute VIVIMIND™ in other markets.
- NRM8499 – At the end of the first quarter of 2010, BELLUS Health initiated a phase I clinical study for NRM8499, a prodrug of tramiprosate intended for the treatment of Alzheimer's disease. Results of the study indicated that NRM8499 was safe and well tolerated at the intended therapeutic dose. The Company will now be seeking a potential partnership to take this investigational product candidate further in its development process.

Finally, we moved forward on a number of organizational initiatives in 2010 to make the Company leaner and more efficient. To further reduce the Company's burn rate and extend our cash resources, we focused our activities on supporting our existing partnerships and product pipeline while significantly reducing our fixed-cost base. We significantly reduced the Company's head count by more than 75% and plan to be 10 full time employees by mid-year. We exercised our right to terminate the lease for our premises in Laval, Quebec, substantially reducing our operating costs. Finally, subsequent to year-end, we initiated a corporate reorganization process to streamline our international structure and repatriate our intellectual property to Canada. Together, these initiatives are expected to decrease BELLUS Health's burn rate to approximately $0.4 million per month by the end of the second quarter of 2011. Our current cash position of $10.3 million provides us with capital into 2013.

We strongly believe that the execution of our revised business plan will deliver value for shareholders. With a leaner and more efficient structure, several strategic partnerships in place and promising products, BELLUS Health is today much more solidly positioned for the future.

Although necessary to ensure our Company's sustainability and success, the strategic initiatives implemented in 2010 entailed some difficult decisions that had direct consequences for some of our employees. I would like to thank each one of them, past and present, for their dedication and commitment throughout the last year. I would also like to express my gratitude to the members of our board of directors — including Mr. Franklin Berger and Dr. Martin Tolar, who joined the board in 2010 — for their encouragement and guidance as we implemented our new business plan. Finally, I wish to thank our shareholders for believing in BELLUS Health's great potential.

I look forward to the continued execution of our plan in 2011.

Sincerely,

Roberto Bellini
President and Chief Executive Officer

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MANAGEMENT'S DISCUSSION AND ANALYSIS

BELLUS Health Inc. and its subsidiaries (BELLUS Health or the Company) is a development-focused health company concentrating on research and development of products that provide innovative health solutions and address critical unmet medical needs. The Company's shares trade on the Toronto Stock Exchange (TSX) under the symbol BLU.

The Management's Discussion and Analysis (MD&A) provides a review of the Company's operations and financial performance for the years ended December 31, 2010 and 2009. It should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2010, which have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Additional information relating to the Company, including its Annual Report and Annual Information Form, as well as registration statements and other public filings, is available on SEDAR at www.sedar.com.

This document contains forward-looking statements, which are qualified by reference to, and should be read together with the "Forward-Looking Statements" cautionary notice, which can be found at the end of this MD&A.

This MD&A was prepared by Management with information available as at February 22, 2011.

As previously reported, effective January 1, 2010, the Company adopted the Canadian (CDN) dollar as its functional and reporting currency as a significant portion of its expenses, assets, liabilities and financing are denominated in CDN dollars. All currency figures reported in the consolidated financial statements and in this document, including comparative figures, are in CDN dollars, unless otherwise specified. Refer to Critical accounting policies and estimates section for more details.

BUSINESS OVERVIEW

During 2010, the Company signed agreements in relation to KIACTA™ and VIVIMIND™, as well as pursued its effort to reduce the burn rate. On August 9, 2010, the Company announced that it will gradually reduce its workforce to focus on supporting its current and future strategic partnerships and on undertaking less expensive product development programs for NRM8499 to extend its cash resources. In addition, the Company has initiated a corporate reorganization process whereby the Company will unwind its international structure by closing its subsidiaries in Europe and the United States. It is expected that the Company will have approximately 10 employees in the second quarter of 2011. On January 14, 2011, the Company exercised the right to terminate the lease of its Laval, Quebec premises, effective April 7, 2011 which will result in annual savings of approximately $4.5 million for the Company. As at February 22, 2011, the Company had cash and cash equivalents in the amount of $8,374,000. Following these cost reduction initiatives implemented by the Company, the monthly burn rate is expected to decrease to approximately $400,000 by the end of the second quarter of 2011, based on the Company's current estimates.

The current status of the Company's principal pharmaceutical product candidates is as follows:

Disease indication	Product candidate	Stage of development
Amyloid A (AA) amyloidosis	KIACTA™ (eprodisate) [(1)]	Phase III clinical trial
Alzheimer's disease	NRM8499, prodrug of tramiprosate	Phase I Clinical trial

[(1)] See below for details of the asset and license agreement signed in April 2010 in relation to KIACTA™ (eprodisate).

KIACTA™ (eprodisate) is the Company's oral investigational product candidate for the treatment of AA amyloidosis, a potentially fatal disease which is often associated with kidney dysfunction.

On April 29, 2010, the Company signed an asset sale and license agreement with Celtic Therapeutics (Celtic), pursuant to which Celtic acquired and licensed worldwide rights related to the Phase III investigational product candidate KIACTA™ (eprodisate) for upfront proceeds totalling US$10 million, paid in two instalments of US$5 million. On April 29, 2010, the Company received up-front payment of US$5 million and received the second instalment of US$5 million on November 4, 2010. Celtic will fund 100% of KIACTA™'s development costs through its confirmatory Phase III clinical study and all other requirements for KIACTA™'s regulatory approval. Celtic will then conduct an auction process for the commercialization rights of KIACTA™. Ultimately, the overall proceeds of the auction process are expected to be shared equally between Celtic and the Company. In conjunction with the asset sale and license agreement, a service agreement has been signed for an expected amount of US$745,000 over the life of the agreement to provide support and assistance to Celtic in connection with their development plan concerning KIACTA™.

On December 14, 2010, a global confirmatory phase III clinical study was initiated for KIACTA™ (eprodisate). The study is designed to confirm the safety and efficacy of KIACTA™ in preventing renal function decline in patients with AA amyloidosis. The international, randomized, double-blind, placebo-controlled, event-driven study will involve approximately 230 patients diagnosed with AA amyloidosis enrolled from approximately 90 sites in 30 countries worldwide. The primary efficacy composite endpoint of the study is based on patients reaching an event linked to the deterioration of their renal function, defined as a persistent decrease in creatinine clearance (CrCl) of 40% or more, a persistent increase in serum creatinine (SCr) of 80% or more, or progression to end-stage renal disease (ESRD). The primary efficacy analysis will be the time from baseline to the first renal deterioration event of the primary composite endpoint. The study is tentatively planned to end when approximately 104 renal events have occurred. The number of events and enrolment target for the study will be reviewed and may be refined following an interim analysis which will be conducted following the occurrence of at least 20 events and 15 months after the enrolment of the first patient. It is currently estimated that the study will be completed in 2014.

In 2005, the Company completed an initial Phase II/III clinical trial for KIACTA™ (eprodisate) for the treatment of AA amyloidosis. The Company had filed for marketing approval of KIACTA™ (eprodisate) for the treatment of AA amyloidosis in the US and received, in July 2007, an approvable letter from the US Food and Drug Administration (FDA) indicating that an additional efficacy trial will be necessary before the FDA could approve the investigational product candidate. BELLUS Health had also filed for marketing approval of KIACTA™ (eprodisate) for the treatment of AA amyloidosis in the European Union and Switzerland. In December 2007, the Committee for Medicinal Products for Human Use (CHMP), the scientific committee of the European Medicines Agency (EMEA), also concluded that another study would be needed to confirm the effectiveness of KIACTA™ (eprodisate). Accordingly, the Company withdrew its marketing applications for KIACTA™ (eprodisate) in the US, the European Union and Switzerland.

KIACTA™ (eprodisate) has been granted Orphan Drug Designation in the US and received Orphan Medicinal Product designation in Europe, which normally provide for market exclusivity of seven years and ten years, respectively, once the drug is approved. KIACTA™ (eprodisate) has also received Orphan Drug Designation in Switzerland.

The Company is also developing a prodrug of tramiprosate (ALZHEMED™; homotaurine) for the treatment of Alzheimer's disease (AD). Following the termination of the tramiprosate (ALZHEMED™; homotaurine) pharmaceutical drug development program for the treatment of AD in 2007, the Company took the decision to leverage the numerous years of accumulated knowledge and experience it had gained in developing tramiprosate (ALZHEMED™) for AD, and to prioritize the development of its next generation prodrug candidate of tramiprosate into preclinical development for the treatment of AD. During the first quarter of 2010, the Company initiated a Phase I clinical study for NRM8499, a prodrug of tramiprosate, which is intended for the treatment of AD. The randomized, double-blind, placebo-controlled study investigated the safety, tolerability and pharmacokinetic profile of NRM8499 in a group of 67 young and elderly healthy subjects. NRM8499 has been identified by BELLUS Health as a compound which increases the brain exposure to tramiprosate. Preclinical studies conducted in rodents showed that NRM8499 increased plasma and brain exposure to tramiprosate by 1.5 to 3 fold. The Company believes that an increase in the exposure of tramiprosate to the brain may help improve the therapeutic effect on cognitive function and other clinical outcomes in AD. The Phase I clinical study for NRM8499 has been completed in the fourth quarter of 2010. Results of the Phase I clinical study indicated that NRM8499 was safe and well tolerated at the intended therapeutic dose. Moreover, the gastrointestinal tolerability and pharmacokinetic profile of tramiprosate, with regards to the inter-individual variability in drug systemic exposure, were meaningfully improved with NRM8499 when compared to the administration of an equivalent dose of tramiprosate.

The Company was also investigating the efficacy of NC-503 (eprodisate) for the treatment of Type II diabetes and certain features of metabolic syndrome. During the second quarter of 2008, a Phase II clinical trial in diabetic patients was initiated in Canada. On May 4, 2010, the Company announced its decision to discontinue the NC-503 (eprodisate) diabetes development program due to lack of efficacy in the Phase II clinical trial.

Given the early stage of the Company's pharmaceutical prodrug product candidate, it is impossible to outline the nature, timing or estimated costs necessary to complete these projects, nor the anticipated completion dates for these projects. The facts and circumstances indicating the uncertainties that preclude the Company from making a reasonable estimate of the costs and timing necessary to complete projects include the risks inherent in any clinical trials, the uncertainty as to the nature and extent of regulatory requirements both for safety and efficacy, and the ability to manufacture the products in accordance with current good manufacturing requirements and in sufficient quantities both for large scale trials and for commercial use.

In September 2008, the Company launched its first product, VIVIMIND™ (tramiprosate; homotaurine), in Canada and globally on the Internet. VIVIMIND™ is a natural health brand designed to protect memory function and is based on homotaurine, a naturally occurring ingredient found in certain seaweed. VIVIMIND™ is the direct result of over 15 years of significant scientific research, including clinical testing in over 2,000 individuals. On September 30, 2010, a Natural Health Product Number (NPN) was issued by Health Canada for VIVIMIND™, which grants formal authorization for sale in Canada. In January 2010, the National Association of Pharmacy Regulatory Authorities (NAPRA) issued a directive to provincial pharmacists associations requesting that pharmacists not sell natural health products that have not been issued an NPN. At that time, the Company took a decision to temporarily cease its sales and marketing activities for VIVIMIND™ and have the product available only on the Internet.

During 2010, the Company entered into two regional agreements in relation to VIVIMIND™. On December 31, 2010, the Company entered into a share purchase agreement with Advanced Orthomolecular Research Inc (AOR) for the shares of OVOS Natural Health Inc. (OVOS), the Company's wholly-owned Canadian nutraceutical subsidiary. In addition, the Company and AOR entered into an exclusive license and supply agreement relating to the distribution of VIVIMIND™ in Canada. Pursuant to the share purchase agreement, AOR acquired all issued and outstanding shares of OVOS for a total consideration of $1 million, consisting of an upfront payment of $350,000 and of a payment of $650,000 contingent upon the successful completion of a pre-established milestone event expected to occur within 18 months of the closing of the transaction. Pursuant to the license and supply agreement, the Company granted AOR exclusive distribution rights for VIVIMIND™ in Canada and will be supplying AOR with material for the product at a pre-agreed transfer price. The license and supply agreement also provides for up to $3 million in commercial milestone payments to BELLUS Health should certain mutually agreed upon sales targets be achieved.

On October 19, 2010, the Company, with the approval of a Special Committee of the Board of Directors, signed a license and supply agreement relating to the distribution of VIVIMIND™ in Italy with FB Health LLC (FB Health). Pursuant to the license and supply agreement, the Company granted FB Health exclusive distribution rights for VIVIMIND™ in Italy, for a consideration consisting primarily of up to €3 million in commercial milestone payments, should certain mutually agreed upon sales targets be achieved. The license and supply agreement also provides for BELLUS Health to supply material for the product to FB Health at a pre-agreed transfer price. Regulatory approval for the sale of VIVIMIND™ in Italy for memory function protection and the maintenance of cognitive health was granted in 2009. FB Health is an Italian nutraceutical company controlled by Dr. Francesco Bellini, Chairman of the Board of Directors of BELLUS Health.

On the regulatory front, the Company continues to move forward on its original goal of making VIVIMIND™ available on a worldwide basis. With respect to the United States, the Company has filed a premarket notification of a New Dietary Ingredient for homotaurine with the FDA, and is pursuing mandatory associated regulatory activities to obtain marketing approval for homotaurine as a dietary supplement.

Effective January 1, 2010, Mr. Roberto Bellini had been named President and Chief Executive Officer of the Company. Dr. Francesco Bellini, former President and Chief Executive Officer, remains Chairman of the Board of Directors and is also providing ongoing advisory services to the Company, thus enabling BELLUS Health to continue to benefit from his vast expertise and knowledge of the health sciences and the pharmaceutical industries.

As at December 31, 2010, the major shareholders of the Company were Victoria Square Ventures Inc. (VSVI), a subsidiary of Power Corporation of Canada, and Vitus Investments III Private Limited (VITUS), a corporation whose shares are beneficially owned by Mr. Carlo Bellini, which held approximately 21% and 16%, respectively, as of that date, based on the issued and outstanding shares of the Company.

On August 9, 2010, the Company announced that it will gradually reduce its workforce by more than two thirds, to focus on supporting its current and future strategic partnerships and on undertaking less expensive product development programs for NRM8499 to extend its cash resources. The one-time costs associated with this reduction, totalling approximately $1,655,000, were expensed in the third quarter of 2010. In connection with the restructuring, the Company has implemented a plan to sell its excess research and office equipment.

The Company initiated a corporate reorganization process whereby the Company will unwind its international structure by closing its subsidiaries in Europe and the United States. The completion of the corporate reorganization, which is expected to occur in the first quarter of 2011, will result in the repatriation of BELLUS Health's intellectual property to Canada. As at December 31, 2010, the Company had significant tax losses that may be used to reduce future taxable income. See note 14 of the consolidated financial statements for the year ended December 31, 2010 for more details. The corporate reorganization will have an impact on the availability of the Company's tax losses.

FINANCIAL POSITION AND GOING CONCERN

To date, the Company has financed its operations primarily through public offerings of common shares, private placements, issuance of convertible notes, as well as a sale-leaseback transaction, research tax credits, collaboration and research contracts, asset sale, licensing and supply agreements, interest and other income. The future operations and profitability of the Company are dependent upon such factors as the success of the clinical trials, the approval by regulatory authorities of products developed by the Company, the ability of the Company to successfully market, sell and distribute products and the ability of the Company to obtain the necessary financing to complete its projects. In January 2009, the Company delisted its shares from NASDAQ. Additionally, in May 2009, the Company deregistered its securities from the US Securities and Exchange Commission (SEC). The Company's shares trade on the TSX.

The Company has incurred significant operating losses and negative cash flows from operations since inception and has an accumulated deficit of $477,629,000 as at December 31, 2010. As at that date, the Company had cash and cash equivalents in the amount of $10,257,000, mainly as a result of signing an agreement with Celtic during the second quarter of 2010, as discussed above. As at February 22, 2011, the Company had cash and cash equivalents in the amount of $8,374,000. Following the cost reduction initiatives implemented by the Company, including the corporate reorganization as discussed above, and the exercise of the option to terminate the lease, effective April 7, 2011, the monthly burn rate is expected to decrease to approximately $400,000 at the end of the second quarter of 2011, based on the Company’s current estimates. The burn rate of the upcoming quarters is dependent upon the level of development activities in relation to the Company’s product candidates.

As at December 31, 2010, the Company’s committed sources of funds, and the cash and cash equivalents on hand is expected, in management’s view, to be sufficient to meet its committed cash obligations and expected level of expenditures over the next twelve months. However beyond that, the ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through sale of assets, supply agreements or product licensing agreements, and from obtaining regulatory approval in various jurisdictions to market and sell its product candidates and ultimately achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company’s control. These material uncertainties continue to raise significant doubt about the Company’s ability to continue as a going concern in the foreseeable future.

Management continues to pursue additional sources of funds including through further arrangements relating to the distribution of VIVIMIND™, its natural health brand. While the discussions could lead to the signing of binding agreements in the future, there can be no assurance whatsoever that any such transaction will be put in place. As a result, there is material uncertainty as to whether the Company will have the ability to continue as a going concern in the foreseeable future and thereby realize its assets and discharge its liabilities in the normal course of business.

The consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. The consolidated financial statements do not include any adjustments to the carrying value and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to receive significant funds on signing collaborative research and development contracts, licensing and supply agreements or by out-licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes, would be reduced to liquidation value.

Selected Financial information

(In thousands of dollars, except per share data)

	Years ended December 31		
	2010	2009 [1]	2008 [1]
Revenues:	$	$	$
Asset sale, licensing and supply agreements	2,218	-	-
Net product sales	190	(113)	331
Collaboration agreement	-	-	219
Reimbursable costs	-	-	74
	2,408	(113)	624
Expenses:			
Research and development	8,464	12,920	26,699
Research tax credits and grants	(1,409)	(1,322)	(1,526)
	7,055	11,598	25,173
General and administrative	6,466	5,814	12,326
Marketing and selling	612	4,360	7,106
Reimbursable costs	-	-	74
Stock-based compensation	1,228	2,646	2,463
Depreciation and equipment write-off	1,466	790	928
Net expense (credit) for vacant space	272	(2,277)	-
	17,099	22,931	48,070
Loss before undernoted items	(14,691)	(23,044)	(47,446)
Interest income	152	113	968
Interest and bank charges	(527)	(368)	(289)
Accretion expense	(6,717)	(5,861)	(5,267)
Change in fair value embedded derivatives	19	44	92
Gain on extinguishment of debt	-	20,530	-
Change in fair value of New ABCP Notes	663	258	330
Foreign exchange gain (loss)	988	(462)	306
Net Loss	(20,113)	(8,790)	(51,306)

[1] Prior periods have been restated to reflect the change in functional currency. See Change in functional and reporting currency section for details on the Company's change in functional currency to CDN dollars.

Selected Financial information (continued)

(In thousands of dollars, except per share data)

	December 31, 2010	December 31, 2009 [1]	December 31, 2008 [1]
Net loss per share – Basic	(0.10)	(0.06)	(1.04)
Net loss per share – Diluted	(0.10)	(0.19)	(1.04)
Total assets	21,071	29,351	32,349
Total long-term liabilities	39,226	37,873	77,408

[1] Prior periods have been restated to reflect the change in functional currency. See Change in functional and reporting currency section for details on the Company's change in functional currency to CDN dollars.

RESULTS OF OPERATIONS

Year ended December 31, 2010, compared to the year ended December 31, 2009

Revenue from asset sale, licensing and supply agreements amounted to $2,218,000 for the year ended December 31, 2010. Revenue of $413,000 is in relation to the VIVIMIND^{TM} agreements entered into with FB Health and AOR, as previously discussed. Revenue from asset sale, licensing and supply agreements also consists of $1,805,000 in relation to the asset sale and license agreement as well as to the service agreement signed with Celtic on April 29, 2010, as previously discussed. Revenue, under both Celtic agreements, is recognized on a straight line basis over the development phase conducted by Celtic, estimated to be 49 months, as that time period is considered to be management's best estimate of the pattern of performance of all deliverables.

Net product sales amounted to $190,000 for the year ended December 31, 2010, compared to negative $113,000 for the same period the previous year. These sales represent the sales of VIVIMIND^{TM} (also known as tramiprosate and homotaurine). Negative net sales recorded in 2009 are attributable to a provision recorded in relation to the Company's decision to reduce VIVIMIND™'s suggested retail price in July 2009 as well as to a provision recorded for potential returns of expired products.

Research and development expenses before research tax credits and grants, amounted to $8,464,000 for the year ended December 31, 2010, compared to $12,920,000 for the previous year. The decrease is mainly attributable to a reduction in expenses incurred in relation to the NC-503 (eprodisate) Phase II clinical trial for the treatment of Type II diabetes and certain features of metabolic syndrome, which ended in the first half of 2010.

Research tax credits and grants amounted to $1,409,000 for the year ended December 31, 2010, compared to $1,322,000 for the previous year. Research tax credits represent refundable tax credits earned under the Quebec Scientific Research and Experimental Development Program for expenditures incurred in Quebec. The research tax credits recorded are those management believes there is reasonable assurance of their recovery. The increase is due to the realization of tax credits from prior years that met the criteria for recognition during the current year.

General and administrative expenses amounted to $6,466,000 for the year ended December 31, 2010, compared to $5,814,000 for the previous year. The increase is mainly due to transaction costs in relation to the KIACTA™ and VIVIMIND™ transactions as well as severance costs in connection with the reduction in the Company's workforce, which was recorded during the quarter ended September 30, 2010, as previously discussed.

Marketing and selling expenses amounted to $612,000 for the year ended December 31, 2010, compared to $4,360,000 for the previous year and represent expenses incurred in relation to the commercialization of the Company's natural health brand, VIVIMIND^{TM}. The decrease is due to the Company's decision in February 2010 to cease its marketing and sales activities for VIVIMIND^{TM} and have the product only available on the Internet.

Stock-based compensation amounted to $1,228,000 for the year ended December 31, 2010, compared to $2,646,000 for the previous year. This expense relates to stock options and stock-based incentives, whereby compensation cost in relation to stock options is measured at fair value at the date of grant and is expensed over the award's vesting period. The decrease in the current period is due to the reduction of the liability in relation to the Company's deferred share unit plan, as a result of the decrease in the market value of the Company's common shares.

Depreciation and equipment write-off amounted to $1,466,000 for the year ended December 31, 2010, compared to $790,000 for the previous year. The increase is due to an impairment loss of $1,018,000 recorded in 2010 to reflect the net realizable value of the assets held for sale, in connection with the Company's plan to sell its excess research and office equipment, as discussed above.

Net expense for vacant space amounted to $272,000 for the year ended December 31, 2010, compared to a net credit for vacant space of $2,277,000 for the previous year and is in relation to the vacancy of a portion of the Company's premises following the reduction in the Company's research activities and associated workforce announced in 2010 and 2009. The Company recorded an additional provision as a result of the workforce reduction in the quarter ended September 30, 2010.

Accretion expense amounted to $6,717,000 for the year ended December 31, 2010, compared to $5,861,000 for the previous year. Accretion expense represents the imputed interest under GAAP on the 2006, 2007 and 2009 convertible notes, and liability portion of the preferred shares. The Company accretes the carrying value of these items to their face value through a charge to earnings over their expected life. As of December 31, 2010, face value in the amount of US$13,000,000 of 2006 Amended Notes, US$500,000 of 2007 Amended Notes and $21,115,000 of 2009 Notes, excluding accrued interest, remained outstanding. The increase in the current period is mainly due to the increasing accretion expense recorded on the 2009 convertible notes as they advance to maturity.

Gain on extinguishment of debt amounted to $20,530,000 for the year ended December 31, 2009, and resulted from amendments to the terms of the 2006 and 2007 Notes that took place at the time of a refinancing of the Company in April 2009.

Change in fair value of New Asset-Backed Commercial Paper (ABCP) *Notes* increased by $663,000 for the year ended December 31, 2010, compared to an increase of $258,000 for the previous year. This represents net changes during the periods on the valuation of New ABCP Notes held by the Company. Refer to Financial condition – Investing activities section for details.

Foreign exchange gain amounted to $988,000 for the year ended December 31, 2010, compared to a loss of $462,000 for the previous year. Foreign exchange gains for the year ended December 31, 2010, arose on the movement in foreign exchange rates in relation to the Company's net monetary assets denominated in currencies other than CDN dollars, the Company's functional and reporting currency, such net monetary assets consisting primarily of assets and liabilities denominated in US dollars. Refer to the Critical accounting policies and estimates section for details on the Company's decision to adopt the CDN dollar as its functional and reporting currency, effective January 1, 2010.

Year ended December 31, 2009, compared to the year ended December 31, 2008

Net product sales amounted to negative $113,000 for the year ended December 31, 2009, compared to $331,000 for previous year. The decrease in net sales for the year ended December 31, 2009, compared to the previous year is mainly attributed to provisions following the Company's decision to reduce the price of VIVIMIND™ in July 2009, and the Company's estimate of potential expired products to be returned in the first half of 2010. The decision to reduce the price of VIVIMIND™ was supported by changing economic conditions, as well as by comments from consumers, healthcare providers and retail customers.

Research and development expenses, before research tax credits and grants, amounted to $12,920,000 for the year ended December 31, 2009, compared to $26,699,000 for the previous year. The decrease is mainly attributable to a reduction in expenses incurred in relation to the wind-down of the tramiprosate (ALZHEMED™; homotaurine) Phase III study for the treatment of AD, following the Company's decision in November 2007 to terminate the tramiprosate (ALZHEMED™) pharmaceutical drug development program.

Research tax credits and grants amounted to $1,322,000 for the year ended December 31, 2009, compared to $1,526,000 for the previous year. Research tax credits represent refundable tax credits earned under the Quebec Scientific Research and Experimental Development Program for expenditures incurred in Quebec. The research tax credits recorded are those management believes there is reasonable assurance of their recovery.

General and administrative expenses amounted to $5,814,000 for the year ended December 31, 2009, compared to $12,326,000 for the previous year. Expenses for 2009 are presented net of an amount of $4,515,000 in relation to amortization of the deferred gain on sale of property compared to $1,428,000 for the corresponding period the previous year due to modification of the lease term. The decrease is also due to a reduction in the workforce during the first quarter ended March 31, 2009, as well as other additional measures implemented by the Company to reduce its burn rate.

Marketing and selling expenses amounted to $4,360,000 for the year ended December 31, 2009, compared to $7,106,000 for the previous year and represent expenses incurred in relation to the commercialization of the Company's natural health brand, VIVIMIND™. The decrease is due to a reduction in marketing activities during 2009, compared to the previous year, during which the product was launched.

Stock-based compensation amounted to $2,646,000 for the year ended December 31, 2009, compared to $2,463,000 for the previous year. This expense relates to stock options and stock-based incentives, whereby compensation cost in relation to stock options is measured at fair value at the date of grant and is expensed over the award's vesting period.

Net credit for vacant space amounted to $2,277,000 for the year ended December 31, 2009, and is in relation to the vacancy of a portion of the Company's premises following the reduction in the Company's research activities and associated workforce. Refer to Liquidity and capital resources section for details.

Interest income amounted to $113,000 for the year ended December 31, 2009, compared to $968,000 for the previous year. The decrease is mainly attributable to lower average cash balances and lower interest rates during the current year compared to the previous year.

Accretion expense amounted to $5,861,000 for the year ended December 31, 2009, compared to $5,267,000 for the previous year. Accretion expense represents the imputed interest under GAAP on the 2006, 2007 and 2009 convertible notes, and liability portion of the preferred shares. The Company accretes the carrying values of these items to their face values through a charge to earnings over their expected lives. As of December 31, 2009, the face value in the amount of US$13,000,000 of the 2006 Amended Notes, US$500,000 of the 2007 Amended Notes and $21,115,000 of the 2009 Notes, excluding accrued interest, remained outstanding.

Gain on extinguishment of debt amounted to $20,530,000 for the year ended December 31, 2009, and resulted from amendments to the terms of the 2006 and 2007 Notes that took place at the time of a refinancing of the Company in April 2009.

Change in fair value of New ABCP *Notes* increased by $258,000 for the year ended December 31, 2009, compared to an increase of $330,000 for the previous year. This represents net changes during the periods on the valuation of New ABCP Notes held by the Company.

Foreign exchange loss amounted to $462,000 for the year ended December 31, 2009, compared to a gain of $306,000 for the previous year. Foreign exchange gains or losses arise on the movement in foreign exchange rates in relation to the Company's net monetary assets denominated in currencies other than US dollars, the Company's functional and reporting currency in 2009 and 2008, such net monetary assets consisting primarily of assets and liabilities denominated in CDN dollars. Foreign exchange gains for the comparative year include $1,132,000 of gain recognized on the reclassification of the refundable amount (US$6,000,000) due to Centocor, Inc., from deferred revenue (non-monetary liability) to accrued liability (monetary liability) following the recovery by the Company of ownership rights in and control of KIACTA™ (eprodisate). Refer to the Critical accounting policies and estimates section for details on the Company's decision to convert to the CDN dollar as its functional currency, effective January 1, 2010.

Fourth quarter (unaudited)

For the fourth quarter ended December 31, 2010, the Company recorded a *net loss* of $3,817,000 ($0.02 per share), compared to $5,662,000 ($0.03 per share) for the corresponding quarter the previous year.

Revenue from asset sale, licensing and supply agreements for the quarter ended December 31, 2010, amounted to $971,000 and is in relation to the VIVIMIND™ agreements entered into with FB Health and AOR as well as to the asset sale and license agreement entered into with Celtic, as previously discussed.

Net product sales amounted to $68,000 for the quarter ended December 31, 2010, compared to negative $116,000 for the same period the previous year. Negative net sales recorded in 2009 are attributable to a provision recorded in relation to the potential returns of expired products.

Research and development expenses before research tax credits and grants, amounted to $1,864,000 for the quarter ended December 31, 2010, compared to $2,722,000 for the corresponding quarter the previous year. The decrease in the three-month period is mainly attributable to a reduction in expenses incurred in relation to the Phase II clinical trial of NC-503 (eprodisate) for the treatment of Type II diabetes and certain features of metabolic syndrome which ended in the first half of 2010.

Research tax credits and grants amounted to $182,000 for the quarter ended December 31, 2010 compared to $584,000 for the same period the previous year. Research tax credits represent refundable tax credits earned under the Quebec Scientific Research and Experimental Development Program for expenditures incurred in Quebec. Tax credits recorded in the prior year quarter included adjustments to reflect the increase in the tax credit rate for which there was reasonable assurance of their recovery.

General and administrative expenses amounted to $1,204,000 for the quarter ended December 31, 2010, compared to $557,000 for the corresponding period the previous year. Expenses for the current quarter are presented net of an amount of $1,190,000 in relation to amortization of the deferred gain on sale of property compared to $1,315,000 for the corresponding period the previous year. The increase in the current quarter is mainly due to corporate reorganization costs.

Marketing and selling expenses amounted to $102,000 for the quarter ended December 31, 2010, compared to $450,000 for the corresponding quarter the previous year. The decrease is due to the Company's decision in February 2010 to cease its marketing and sales activities for VIVIMIND™ and have the product only available on the Internet.

Stock-based compensation amounted to $555,000 for the quarter ended December 31, 2010, compared to $383,000 for the quarter the previous year. The increase in the current quarter is due to the increase of the liability in relation to the Company's deferred share unit plan, as a result of the increase in the market value of the Company's common shares, offset by stock-based compensation expense no longer being recognized on forfeitures of stock options, which occurred as a result of the reduction in the workforce.

Depreciation and equipment write-off amounted to negative $156,000 for the quarter ended December 31, 2010, compared to $195,000 for the quarter the previous year. The negative amount in the current period is due to an increase in the estimated net realizable value of the assets held for sale, in connection with the Company's plan to sell its excess research and office equipment, as discussed above.

Change in fair value of New ABCP *Notes* increased by $56,000 for the quarter ended December 31, 2010, compared to a decrease of $244,000 for the same quarter the previous year. This represents net changes during the periods on the valuation of New ABCP Notes held by the Company.

Quarterly results (unaudited)
(*in thousands of dollars, except per share data)*

Quarter	Net Revenue	Net (loss) income	Basic net (loss) income per share	Diluted net loss per share
	$	$	$	$
Year ended December 31, 2010				
Fourth	1,039	(3,817)	(0.02)	(0.02)
Third	764	(6,287)	(0.03)	(0.03)
Second	536	(5,816)	(0.03)	(0.03)
First	69	(4,193)	(0.02)	(0.02)
Year ended December 31, 2009				
Fourth [1]	(116)	(5,662)	(0.03)	(0.03)
Third [1]	108	(6,410)	(0.04)	(0.04)
Second [1]	(210)	15,627	0.12	(0.03)
First [1]	105	(12,345)	(0.25)	(0.25)

[1] Prior periods have been restated to reflect the change in functional currency. See Change in functional and reporting currency section for details on the Company's change in functional currency to CDN dollars.

The following explains the variation of the net (loss) income of a quarter compared to the corresponding quarter of the previous year. The decrease in net loss for the quarter ended December 31, 2010, is primarily due to revenue from the KIACTA™ asset sale and license agreement and revenue in relation to the sale of OVOS, as well as a decrease in research and development expenses. The decrease in net loss for the quarter ended September 30, 2010, is primarily due to the revenue from the KIACTA™ asset sale and licensing, as well as a decrease in marketing and selling expenses and stock-based compensation, offset by an increase in general and administrative expenses in connection with the workforce reduction and an increase in depreciation and equipment write-off. Net income for the quarter-ended June 30, 2009, includes a gain on extinguishment of debt in the amount of $20,530,000 and a net credit for vacant space in the amount of $2,474,000. Excluding these gains, the decrease in net loss for the quarter ended June 30, 2010, is primarily due to a reduction in research and development expenses. The decrease in net loss for the quarter ended March 31, 2010, is primarily due to a reduction in research and development expenses, in general and administrative expenses due to additional measures implemented by the Company to reduce its burn rate, and in marketing activities in relation to VIVIMIND™.

Related party transactions

In March 2003, BELLUS Health entered into a management services agreement with Picchio International Inc. (Picchio International) into which Picchio Pharma Inc. intervened, which was subsequently amended. Picchio International is wholly-owned by Dr. Francesco Bellini and his spouse. The management services agreement stipulated that Picchio International provide the services of Dr. Francesco Bellini, as Chief Executive Officer of the Company and services of other members of Picchio International and Picchio Pharma Inc. Under the agreement, Picchio International and Picchio Pharma Inc. provided regular consulting and advisory services, including services related to reviewing existing and potential research and development activities, and potential clinical programs, financing activities, partnering and licensing opportunities, commercialization plans and programs, and advising and assisting in investor relations activities. In consideration of all services rendered under the agreement, Picchio International received a monthly fee of approximately $208,000 in 2008 and a portion of 2009. The management services agreement was amended in June 2009 whereby a portion of the management fee was settled in Deferred Share Units (DSUs) ($700,000 for the year ended December 31, 2009). See note 10 (g) of the consolidated financial statements for the year ended December 31, 2010, for the terms of these DSUs. The management services agreement with Picchio International expired on December 31, 2009, which corresponded with Dr. Francesco Bellini's retirement as President and Chief Executive Officer. The Company recorded management fees under the management services agreement of $1,817,000 and $2,518,000 for the years ended December 31, 2009 and 2008, respectively.

Dr. Francesco Bellini remains Chairman of the Board of Directors and provides ongoing advisory services to the Company under the terms of a new consulting and services agreement between the Company and Picchio International. Picchio International receives a monthly fee of $20,833, plus reimbursement of applicable expenses for services rendered under the agreement. The agreement has a one year term and shall renew for successive one year terms. The Company recorded fees and expenses under the consulting and services agreement of $381,000 for the year ended December 31, 2010.

In 2004, the Company entered into an agreement to issue shares with Dr. Francesco Bellini. Refer to the Contractual Obligations section for details.

In relation to the KIACTA™ asset sale and license agreement, the Company recorded fees of $261,000 (US$250,000) during the second quarter of 2010, payable to Dr. Francesco Bellini under the terms of the consulting and services agreement.

The Company entered into a license and supply agreement with FB Health, a company controlled by Dr. Francesco Bellini, as previously discussed.

FINANCIAL CONDITION

Liquidity and capital resources

As at December 31, 2010, the Company had available cash and cash equivalents of $10,257,000, compared to $14,017,000 at December 31, 2009. The decrease is primarily due to funds used in operating activities, offset by funds received in connection with the KIACTA™ asset sale and license agreement.

Financing activities - Amended

On September 10, 2009, the Company completed a $9,687,000 rights offering and issued a total of 52,363,419 common shares at a price of $0.185 per share (the Subscription Price). Under the rights offering, rights were exercised to subscribe for 9,120,177 common shares at the Subscription Price for proceeds of $1,687,000. At the same time, in accordance with the terms of the stand-by purchase agreements entered into by BELLUS Health with Vitus and VSVI (together, the Investors), each of the Investors subscribed for 21,621,621 common shares of BELLUS Health at the Subscription Price for an aggregate of $8,000,000. The Subscription Price represented a 25% discount off the volume weighted average price of the Company's common shares on the TSX during the five trading days immediately preceding the filing of the prospectus on July 15, 2009. The rights offering resulted in the reduction of the conversion price of the 2006 Notes to US$16.03 and rendered such notes immediately convertible, resulted in the reduction of the conversion price of the 2009 Notes to $0.185 and the reduction of the exercise price and an increase in the outstanding number of the outstanding warrants issued in connection with the 2007 Notes. Net proceeds of the rights offering were $9,266,000.

On April 16, 2009 and June 3, 2009, the Company completed a financing consisting of $20,500,000 convertible notes (2009 Notes) with the Investors. The aggregate amount of the 2009 Notes issued to the Investors was increased by $615,000 to cover a set up fee in connection with the financing. The 2009 Notes are secured, subject to certain permitted encumbrances, by a first charge on all of the assets of BELLUS Health and certain of its subsidiaries. Interest will be capitalized on the 2009 Notes at the rate of 15% per year, compounded annually, and the notes and capitalized interest will mature in April 2014. At maturity, capital and interest are payable in cash or common shares of BELLUS Health, at the option of the holder at an initial price of $0.20 per share (the Financing Conversion Price). The 2009 Notes include customary anti-dilution provisions in respect of issuances of securities or distributions to shareholders and, in the event BELLUS Health issues additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, “full ratchet” anti-dilution protection (which will have the effect of lowering the Financing Conversion Price to the new issue price of equity or equity-linked securities) will apply, subject to certain exceptions. Following issuance of the Company’s common shares in September 2009 in relation to a rights offering (refer to note 10 (c) of the consolidated financial statements for the year ended December 31, 2010), the Financing Conversion Price has been adjusted to $0.185. In addition, following issuance of the Company’s common shares in November 2010 in relation to interest payment on the 2006 and 2007 convertible notes, the Financing Conversion Price has been further adjusted to $0.077 (the Adjusted Financing Conversion Price). The 2009 Notes contain adjustment provisions in the event of a change of control, negative covenants, as well as a pre-emptive right in respect of future financings of BELLUS Health. The 2009 Notes issued to VSVI contains certain piggyback rights in favour of VSVI. The exercise of pre-emptive and piggyback rights will be subject to regulatory approval. Under the term of the 2009 Notes, each of Vitus and VSVI has the right to nominate two members to the Board of Directors of BELLUS Health. The Company has amended the previously-disclosed Financing Conversion Price to reflect the impact of the November 2010 issuance of common shares which resulted in the Adjusted Financing Conversion Price being $0.077.

In connection with and as a condition to the 2009 Notes financing, BELLUS Health and all of the existing note holders agreed, in order to reduce cash interest payments, to amend the terms of the outstanding 2006 Notes and 2007 Notes to either make them convertible into a new series of preferred shares of BELLUS Health and to have these notes converted into such preferred shares immediately, or to otherwise amend the existing notes which remained outstanding. In addition, the landlord of BELLUS Health’s premises in Laval, Quebec, agreed, as a condition precedent to the financing, to defer certain rental payments and to accept payment at a later date of the deferred rent in cash or common shares of BELLUS Health (at the then applicable market price) at the option of the Company.

Holders of US$29,085,000 principal amount of 2006 Notes and US$4,000,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into the preferred shares in the authorized capital of BELLUS Health and received 3,096 preferred shares per US$1,000 aggregate principal amount of existing convertible notes (resulting in a conversion price of $0.40 per share). A total of 102,431,160 preferred shares were issued to note holders who elected to receive preferred shares. Such preferred shares are convertible into common shares on a one-to-one basis at the option of the holder, subject to adjustment; entitle the holder to 6% cumulative yield, payable in cash or common shares at the then market price at the option of the Company; and shall be automatically converted into common shares in April 2014. The amendment and immediate conversion of Original Notes into preferred shares triggered a gain on extinguishment of debt in the amount of $13,000,000 during the quarter ended June 30, 2009. The holders of Original Notes that chose not to convert their amended notes immediately into preferred shares retained Original Notes, amended as set out below.

Holders of US$13,000,000 principal amount of 2006 Notes and the one remaining holder of 2007 Notes (aggregate principal amount of US$500,000) agreed to amend the terms of their notes (Amended Notes), without immediate conversion into preferred shares. The amendments include providing for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of BELLUS Health at the then market price of the common shares; replacing the existing conversion rate adjustment period of October 2009 - November 2009 with a period from October 2012 - November 2012 for conversion of the Amended Notes at the then applicable market price of the common shares based on a twenty (20) day volume weighted average price at that time; and replacing the right of the holder to have BELLUS Health redeem the Original Notes in November 2011 with a right to have BELLUS Health first redeem the Amended Notes in January 2014 at the then face value of the Amended Notes. Amendments to the notes also include the removal of certain negative covenants. Amendment of this aggregate US$13,500,000 principal amount of Original Notes triggered a gain on extinguishment of debt in the amount of $7,530,000 during the quarter ended June 30, 2009.

BELLUS Health has agreed that the right to redeem the Amended Notes shall be exercisable 90 days prior to the maturity date of the 2009 Notes issued to the Investors. Any additional unsecured debt, other than operating facilities or debt that is pari passu or junior in ranking to the Amended Notes, shall not mature or be redeemable for cash prior to the date on which the redemption right of the Amended Notes comes into effect. In addition, BELLUS Health has agreed to certain restrictions on its ability to declare or pay dividends in cash while the 2009 Notes are outstanding.

The terms of the 2009 Notes and of the Amended Notes require the continued listing of the Company's shares on the TSX; failure to meet this requirement would be an event default which may result in the convertible notes becoming immediately due and payable. In the event of a delisting of the Company's shares on the TSX, the accrued cumulative yield on the preferred shares would be payable in cash. As announced in the Company's March 31, 2009, press release, the TSX undertook a routine delisting review of BELLUS Health as a result of the Company's having invoked the financial difficulty exemption in connection with the 2009 Notes financing. On October 20, 2009, the Company received confirmation from the TSX that its Listing Committee had determined that the Company satisfies the TSX's continued listing requirements.

As a condition precedent to the 2009 financing, the landlord of the Company's premises in Laval, Quebec agreed to amend the terms of the lease. See section Liquidity and capital resources – Other for further details.

During the year ended December 31, 2010, BELLUS Health issued 7,517,258 common shares (2009 – 3,431,794 common shares) in payment of interest on the outstanding 2006 and 2007 Amended Notes. During the year ended December 31, 2010, the Company issued 20,554,365 common shares (2009 - 4,600,000 common shares) upon conversion of preferred shares.

During the year ended December 31, 2010, 6,831,000 options to purchase common shares were granted (2009 – 825,600 options), 1,062,680 options to purchase common shares were cancelled (2009 - 652,617 options) and 5,500 options to purchase common shares expired (2009 - 102,050).

Investing activities

In 2007, the Canadian third party asset-backed commercial paper (ABCP) market was hit by a liquidity disruption. In 2007, a Pan-Canadian Investors Committee (the Committee) was established to oversee the restructuring of these instruments. In 2009, the Company received the following new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP, pursuant to the terms of the restructuring plan announced by the Committee : $2,306,000 of MAV2 Class A-1 Notes, $2,773,000 of MAV2 Class A-2 Notes, $503,000 of MAV2 Class B Notes, $173,000 of MAV2 Class C Notes, $850,000 of MAV2 IA Tracking Notes, US$5,000,000 of MAV3 IA Tracking Notes, as well as US$977,000 and $985,000 of MAV3 TA Tracking Notes. The legal maturity of the New ABCP Notes is July 15, 2056, but the actual repayment date is expected to be in 2017. As at December 31, 2010, the Company held New ABCP Notes having a principal value of $7,027,000 and US$3,635,000. During the year ended December 31, 2010, the Company received partial payments for capital of $738,000, and for accrued interest of $23,000 (2009 - $2,436,000 and $720,000, respectively). The Company has not recorded any interest income since the initial maturity of the ABCP it held, as the expected interest proceeds were considered in the determination of the fair value of the New ABCP Notes.

On April 20, 2009, in connection with the restructuring of the ABCP market, the Company entered into new secured revolving credit facilities with the chartered bank that sold the ABCP to the Company, with a minimum 2-year term and with options to renew on an annual basis for up to a maximum total potential term of seven years. As of December 31, 2010, these new credit facilities have combined maximum aggregate amounts of approximately $9,789,000 (2009 - $10,856,000, of which $92,000 was not drawn), bear interest at prime rate minus 1% per annum (weighted average effective interest rate was 2.02% in 2010 (2009 - 2.0%)), and are secured by hypothecs having an aggregate principal amount of $18,400,000 on New ABCP Notes issued to the Company, on the securities accounts in which they are held and on all proceeds of these notes. The amount of these new credit facilities decreases as capital payments are received on the New ABCP Notes. In addition, a portion of these facilities and all other obligations of the Company towards the chartered bank are secured by a hypothec on the universality of the Company's assets in the amount of approximately $2,000,000. The revolving credit facilities also include a put option feature which may limit the Company's losses to between 25% and 55% of the New ABCP Notes, subject to certain conditions.

As at December 31, 2010, the Company estimated the fair value of the outstanding balance of the New ABCP Notes at approximately $7,046,000, of which $379,000 is presented as long-term Restricted cash in the consolidated balance sheet, as it is pledged to a bank as collateral for a letter of credit issued in connection with a lease agreement. In connection with its fair value determinations, the Company recorded an increase in fair value of $663,000 for the year ended December 31, 2010, (2009 - increase of $258,000). The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.80% (weighted average rate of 0.58%), depending on the series of the New ABCP Notes. These future cash flows were discounted, according to the series, over a period of up to 7 years and using discount rates ranging from 2.98% to 7.75% (weighted average rate of 6.35%). The Company also took into account the put option feature included in the credit facilities in determining the change in fair value of the New ABCP Notes recognized in earnings. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2010, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company's current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

Other

As a condition precedent to the 2009 financing, the landlord of the Company's premises in Laval, effective April 1, 2009, agreed to amend the lease. As part of the amendment, the Company had the option to terminate the lease in January 2011 (Termination Option) which was exercised on January 14, 2011. On January 21, 2011, in consideration for the exercise of the Termination Option, BELLUS Health issued to the landlord 20,656,320 common shares from treasury at a price of $0.290468 per share, for an aggregate value of $6 million. The early termination of the lease is expected to result in annual savings of approximately $4.5 million for the Company, representing a total of approximately $43 million in aggregate savings over the remainder of the original lease term.

In addition, as part of the lease amendment, the Company deferred payment of base rent by $167,000 per month minus any sublease revenue from April 1, 2009 to April 7, 2011 (the Deferred Rent). The Deferred Rent bears interest at the rate of ten percent (10%) annually, calculated from the first date of the month when any such component of Deferred Rent becomes due and payable. Deferred Rent and the accrued interest are evidenced by promissory notes issued by BELLUS Health to its landlord on the first day of each month when such Deferred Rent becomes due. Deferred Rent in the amount of $4.2 million (including deferred rent payments for the first quarter of 2011 and all accrued interest thereon) will be payable to the landlord on April 7, 2011, in cash or, at the Company's option, through an issuance of additional common shares from treasury.

The reduction of the Company's research activities and associated workforce resulted in vacant space in the Company's premises. During the year ended December 31, 2010, the Company recorded a net expense for vacant space in the amount of $272,000 (net credit of $2,277,000 for the year ended December 31, 2009). As part of the modifications to the lease agreement, the Company had options to terminate the lease before the end of the original term and the Company had determined that these termination options constitute a material modification to the terms of the original lease. It has concluded that the lease should continue to be classified as operating and that the lease term for accounting purposes will end in April 2011. Accordingly, the deferred gain on sale of property and the deferred rent liability, recorded in 2005 at the time of the sale-leaseback transaction on the Company's premises, are amortized on a straight-line basis to April 2011, for the portion of the premises that the Company continues to occupy. The portion of the deferred gain on sale of property and deferred rent liability attributable to the premises no longer occupied by the Company was factored into the net credit for vacant space. The net credit for vacant space also includes a provision for lease consisting of the present value of future lease costs of the vacant portion of the premises, net of an estimate of the sublease rentals that could reasonably be obtained, as well as an amount proportionate to the vacant space of the Termination Option payment. The provision is based on various assumptions, including the Company's estimated borrowing rate and obtainable sublease rates. These assumptions are influenced by market conditions and the availability of similar space nearby.

On March 22, 2010, the Board of Directors approved an incentive compensation agreement whereby, subject to the accomplishment by the Company of certain medium to long-term performance targets, 8,750,000 common shares are to be issued to certain executives or these executives will receive the cash equivalent in lieu calculated at the then market price, at the option of the Company. This incentive compensation arrangement remains subject to certain ongoing conditions, including TSX requirements. As a result of the workforce reduction, the Company's obligation to potentially issue common shares under the March 22, 2010, incentive compensation agreement has been reduced by 750,000 common shares. During the year ended December 31, 2010, the Company has not recorded any stock-based compensation in relation to these shares.

On May 12 and August 9, 2010, the Board of Directors approved incentive compensation agreements whereby, 4,125,000 and 1,650,000 incentive compensation units were issued to the Board of Directors and employees, respectively. An additional 550,000 incentive compensation units were issued in the fourth quarter of 2010, as a result of a new appointment to the Company's Board of Directors. Each incentive compensation unit is equivalent to the market value of one common share of the Company. Subject to the accomplishment by the Company of certain medium to long-term performance targets, each incentive compensation unit will entitle the holder to receive the cash equivalent calculated at the then market price of the Company's common share. During the year ended December 31, 2010, the Company has not recorded any stock-based compensation in relation to these agreements.

As at February 22, 2011, the Company had 159,172,048 common shares outstanding, 220,000 common shares issuable to Dr. Francesco Bellini upon the achievement of specified performance targets, 10,477,161 options granted under the stock option plan, 79,211,160 preferred shares outstanding which are convertible into common shares on a one for one basis, 15,343,102 warrants outstanding, notes outstanding in the amount of US$13,500,000 and $21,115,000, as well as promissory notes in the amount of $4,054,000, which can either be settled in cash or common shares, at the option of the Company.

As at December 31, 2010, assuming that the 2006 and 2007 convertible notes, preferred shares and promissory notes are settled in common shares, including interest, at an assumed market price of $0.16, and that the 2009 convertible notes, including interest, are settled in common shares at the Adjusted Financing Conversion Price, the number of common shares issuable would be 825,523,794, which includes 20,656,320 common shares issued in January 2011 in connection with the Company's exercise of the Termination Option, representing a potential dilution factor of 596%, based on the number of common shares issued and outstanding as at December 31, 2010. The company has amended the previously-disclosed number of common shares issuable and potential dilution factor percentage to reflect the impact of the November 2010 issuance of common shares which resulted in the Adjusted Financing Conversion Price being $0.077.

Contractual Obligations

As at December 31, 2010, BELLUS Health's minimum future contractual obligations are principally for operating leases for facilities, clinical trial outsourcing agreements, consulting fees for Picchio International, as well as payments in relation to the convertible notes and credit facilities. Future contractual obligations by year of maturity are presented below.

	Payments Due by Period *(in thousands of dollars)*				
Contractual obligations	Total	Less than 1 year	2-3 years	4-5 years	More than 5 years
Operating leases [1]	10,805	10,622	183	Nil	Nil
Development costs	251	251	Nil	Nil	Nil
Consulting fees	250	250	Nil	Nil	Nil
Credit facilities[2]	11,224	205	410	410	10,199
Convertible notes [3]	34,542	Nil	Nil	34,542	Nil
Interest payments on convertible notes [3]	23,906	806	1,611	21,489	Nil
Yield on preferred shares [4]	7,746	Nil	Nil	7,746	Nil

[1] Includes the exercise of the Termination Option under the lease in the amount of $6,000 settled with the issuance of common shares in January 2011 as well as Deferred Rent of $4,244 to be settled in April 2011.

[2] Assumes interest on the Credit facilities is calculated at the interest rate in effect at the balance sheet date and principal repayment based on available renewal options to the Company.

[3] Assumes redemption of Amended Notes in January 2014 and redemption of 2009 Notes in April 2014. Refer to note 9 to the consolidated financial statements for the year ended December 31, 2010 for terms and conditions.

[4] Assume yield on preferred shares paid in April 2014. The Company will have the option to settle the accrued cumulative yield with the issuance of common shares.

The Company has not engaged in commodity contract trading or off-balance sheet financing, other than in relation to operating leases and the sale-leaseback transaction, for which the contractual obligations under the operating leases are stated above. In addition, the Company is also responsible for operating costs and taxes under the operating leases.

The Company has letters of credit issued in connection with lease agreements in the amount of $930,000. New ABCP Notes and cash are pledged under these letters of credit and are presented as restricted cash on the consolidated balance sheet as at December 31, 2010. The balance of the New ABCP Notes is pledged under the credit facilities.

In December 2004, the Company entered into an agreement with its then Chief Executive Officer, Dr. Francesco Bellini, to issue to him up to 220,000 common shares upon the execution of the agreement and upon achievement of specified performance targets. In 2005, the Company recorded stock-based compensation in relation to 140,000 common shares to be issued to Dr. Francesco Bellini in connection with his execution and achievement of certain specified performance targets; these shares will be issued by the Company upon formal notification by Dr. Francesco Bellini.

The Company has entered into a number of other agreements, which involve future commitments, including agreements with Parteq Research and Development Innovations and the federal Ministry of Industry (Technology Partnerships Canada Program). Refer to note 12 of the consolidated financial statements for the year ended December 31, 2010.

FINANCIAL RISK MANAGEMENT

This section provides disclosures relating to the nature and extent of the Company's exposure to risks arising from financial instruments, including credit risk, liquidity risk, foreign currency risk and interest rate risk, and how the Company manages those risks.

Credit Risk

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk of the Company as at December 31, 2010, is the carrying value of its financial assets, including the investment in New ABCP Notes. Credit risk relating to cash, cash equivalents, and restricted cash is managed by investing cash resources with major North American and European financial institutions. Cash equivalents are comprised of fixed income instruments with a high credit rating (not less than A-1) as rated by Standard and Poor's. The Company has investment policies that are geared towards the safety and preservation of principal, the Company's liquidity needs and yields that are appropriate. Refer to the Liquidity and Capital Resources section for a discussion of credit risk related to investment in New ABCP Notes.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. As a result of measures implemented by the Company over the past two years such as reducing its workforce, amending its lease agreement and refinancing, the Company has significantly reduced its required cash outflows. As at December 31, 2010, the Company's committed sources of funds, and the cash and cash equivalents on hand is expected, in management's view, to be sufficient to meet its committed cash obligations and expected level of expenditures over the next twelve months. However beyond that, the ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through sale of assets, supply agreements or product licensing agreements, and from obtaining regulatory approval in various jurisdictions to market and sell its product candidates and ultimately achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company's control. These material uncertainties continue to raise significant doubt about the Company's ability to continue as a going concern in foreseeable future.

At December 31, 2010, included in current liabilities are non-cash liabilities such as deferred revenue and deferred gain on sale of property as well as Deferred Rent, debt component of preferred shares, and interest payable on the 2006 and 2007 convertible notes that are expected to be settled with the issuance of common shares from treasury. As a result of these measures, the Company is expected to have the ability to meet obligations as they become due in 2011. Additionally, the Company has issued common shares from treasury for payment of the Termination Option in 2011 to improve working capital.

The Company requires continued access to capital markets to support its operations, as well as to achieve its strategic plans. Any impediments to the Company's ability to continue to meet the conditions contained in its credit facilities and convertible notes as well as the Company's ability to access capital markets, including the lack of financing capability or an adverse perception in capital markets of the Company's financial condition or prospects, could have a materially adverse effect on the Company. In addition, the Company's access to financing is influenced by the economic and credit market environment.

The Company manages liquidity risk through the management of its capital structure, as outlined in Note 18 to the consolidated financial statements for the year ended December 31, 2010 (Capital Disclosures). In addition, the Company manages liquidity risk by monitoring actual and projected cash flows as well as the impact of credit market conditions in the current environment. However, market conditions are beyond the control of the Company. The Board of Directors reviews, approves and monitors the Company's annual operating and capital budgets, as well as any material transactions.

The contractual maturities of financial liabilities at December 31, 2010, are presented in Note 19 (c) to the consolidated financial statements for the year ended December 31, 2010.

Foreign Currency Risk

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Prior to December 31, 2009, the US dollar was the Company's functional and reporting currency. Refer to the Critical accounting policies and estimates section for details on the Company's decision to convert its functional currency to the CDN dollar effective January 1, 2010. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than CDN dollars. The Company's exposure relates primarily to changes in the CDN dollar versus the US dollar exchange rate. For the Company's foreign currency transactions, fluctuations in the respective exchange rates relative to the CDN dollar will create volatility in the Company's cash flows and the reported amounts for revenue and expenses in its consolidated statement of operations. Additional variability arises from the translation of monetary assets and liabilities denominated in currencies other than the CDN dollar at the rates of exchange at each balance sheet date, the impact of which is reported as a foreign exchange gain or loss in the statement of operations. The Company's objective in managing its foreign currency risk is to minimize its net exposures to foreign currency cash flows, by transacting with third parties in the Company's functional currency to the maximum extent possible and practical and holding cash and cash equivalents and incurring borrowings in its functional currency. The Company does not use forward foreign exchange contracts. As at December 31, 2010, the Company holds a significant portion of cash and cash equivalents in US dollars while the majority of its expenses are denominated in CDN dollars. The Company converts the cash and cash equivalents to CDN dollars as needed while awaiting favourable foreign exchange conditions. Note 19 (d) to the consolidated financial statements for the year ended December 31, 2010 provides indication of the Company's significant foreign exchange currency exposures as at that date.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates. The Company's financial instruments exposed to interest rate risk are cash and cash equivalents, restricted cash, investments in New ABCP Notes, credit facilities and convertible notes. The risk that the Company will realize a loss as a result of the decline in the fair value of its cash equivalents is limited because these investments, although available for sale, have short-term maturities. The capacity of the Company to reinvest the short-term amounts with equivalent returns will be impacted by variations in short-term fixed interest rates available in the market.

The Company has had no interest rate hedging activities during the current year.

DISCLOSURE CONTROLS AND PROCEDURES - As amended

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its reports filed with securities regulatory authorities is recorded, processed, summarized and reported within prescribed time periods and is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Company's Chief Executive Officer and its Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in the reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified by applicable securities legislation. The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of certain events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. The Company's Chief Executive Officer and its Chief Financial Officer are assisted in this responsibility by the Company's disclosure committee, which is composed of members of senior management. Based on an evaluation of the Company's disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2010.

In connection with the amendment of the December 31, 2010 financial statements, the Chief Executive Officer and the Chief Financial Officer have re-evaluated the effectiveness of disclosure controls and procedures and internal control over financial reporting. Based on the re-evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2010, disclosure controls and procedures were not effective because the Company had a material weakness in internal control over financial reporting, as described below.

INTERNAL CONTROL OVER FINANCIAL REPORTING - As amended

Management's Annual Report on Internal Control Over Financial Reporting

Internal control over financial reporting (ICFR) is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Management, including the Company's Chief Executive Officer and its Chief Financial Officer, is responsible for establishing and maintaining adequate ICFR. The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of certain events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Management assessed the effectiveness of the Company's ICFR as of December 31, 2010 based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, The Company's Chief Executive Officer and its Chief Financial Officer concluded that the Company's ICFR were effective as of December 31, 2010. This MD&A does not include an attestation report of the Company's auditors regarding ICFR.

As a result of the amendment of the December 31, 2010 financial statements, the Company's Chief Executive Officer and its Chief Financial Officer have re-evaluated the effectiveness of internal control over financial reporting and determined that a material weakness existed at December 31, 2010 and as a result, internal control over financial reporting were not effective. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

An error in misapplication of foreign exchange rates was detected during the audit and an error in the disclosure of the 2009 Notes was detected by the Company. The error in the disclosure of the 2009 Notes resulted in an amendment and refilling of the December 31, 2010 consolidated financial statements and an amendment and refilling of this MD&A. The material weakness related to insufficient personnel with adequate technical skills to appropriately assess the accounting and disclosure of non-routine and complex transactions, as well as to monitor the disclosure in relation to the Company's complex capital structure.

Companies of small capitalization such as BELLUS Health do not necessarily have all the technical knowhow related to financial accounting and disclosure of more complex transactions. In addition, BELLUS Health's capital structure is relatively complex. Therefore, some transactions could be incorrectly reported, resulting in a significant discrepancy in the Company's financial statements. To address this risk, the Company is currently evaluating its alternatives, which may include, increasing the consulting services from legal and accounting specialists to aid in the accounting and disclosure in relation to complex transactions.

Changes in Internal Controls Over Financial Reporting

There have been no changes in the Company's ICFR during the year ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect its ICFR.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements in accordance with GAAP requires management to adopt accounting policies and to make certain estimates and assumptions that the Company believes are reasonable based upon the information available at the time these decisions are made. These accounting policies, estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues, expenses and cash flows during the reporting periods. By their nature, these judgments are subject to an inherent degree of uncertainty and are based upon historical experience, trends in the industry and information available from outside sources. On an ongoing basis, management reviews its estimates and actual results could differ from estimates. Refer to notes 4, 5 and 9 to the consolidated financial statements for estimates used in the valuation of the investment in New ABCP Notes, recognition of revenue and the convertible notes, respectively. The Company's significant accounting policies are described in Notes 2 and 3 to the consolidated financial statements for the year ended December 31, 2010. Management considers that the following accounting policies and estimates are more important in assisting an understanding and evaluating the Company's consolidated financial statements.

Going Concern Assumption: The consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. The consolidated financial statements do not include any adjustments to the carrying value and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to receive significant funds on signing collaborative research and development contracts, licensing and supply agreements or by out-licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes, would be reduced to liquidation value.

Revenue recognition: Revenue from the Company's different agreements is assessed in order to determine whether they contain multiple deliverables. Revenue arrangements with multiple deliverables need to be divided into separate units of accounting based on defined accounting criteria. If separation is required, the consideration received or receivable is allocated among the separate units of accounting based on the relative fair values of each unit. If the fair value of the delivered item is not reliably measurable, then revenue is allocated based on the difference between the total arrangement consideration and the fair value of the undelivered item. The applicable revenue recognition criteria are applied to each of the separate units. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting. Payments received under agreements may include upfront payments, regulatory and sales-based milestone payments for specific achievements, distribution fees, as well as revenue from the supply of products. Revenue for each unit of accounting is recorded as follows: (i) non-refundable upfront payments received on the signing of agreements and regulatory milestone payments, which require the Company's ongoing involvement, are deferred and amortized into income on a straight-line basis over the expected period of performance of the related activities, provided that revenue subject to the achievement of milestones is recognized only when the specified events have occurred and collectability is reasonably assured; (ii) sales-based milestone payments, for which the Company has no future involvement or obligations to perform related to that specified element of the arrangement, are recognized into income upon the achievement of the specified milestones and when collectability is reasonably assured; (iii) distribution fees are recognized when the service has been performed, the amount is determinable and collection is reasonably assured; and (iv) revenue from the supply of products is recognized in accordance with the Company's policy below.

Amounts received or billed in advance of recognition are shown as deferred revenue.

Revenues from the sale or supply of products are recognized when persuasive evidence of an arrangement exists, the product has been delivered, there are no future performance obligations, the selling price is fixed and determinable, and collection is reasonably assured. Sales allowances for products returns and cooperative promotional incentives are recorded at the time sales are recognized as a reduction of revenue.

Research and development costs consist of direct and indirect expenditures, including a reasonable allocation of overhead expenses, associated with the Company's various research and development programs. Research and development costs are expensed as incurred. Overhead expenses comprise general and administrative support provided to the research and development programs and involve costs associated with support activities such as facility operating costs, office services, information technology and human resources. The Company accrues clinical trial expenses based on work performed, which relies on estimates of total costs incurred based on completion of patient studies and other events. The Company follows this method since reasonable dependable estimates of the costs applicable to various stages of a research agreement or clinical trial can be made. Accrued clinical costs are subject to revisions as trials progress to completion. Research tax credits recorded are those management believes there is reasonable assurance of collection. Research tax credits claimed for current and prior years are subject to current government review which could result in adjustment to earnings.

New ABCP Notes: The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company also took into account the put option feature included in the credit facilities in determining the change in fair value of the New ABCP Notes recognized in earnings. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2010, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company's current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

Convertible Notes: Convertible notes are accounted for as a compound financial instrument and are presented in their component parts of debt and equity. The Company allocated the proceeds from the convertible notes between its liability and equity components using the residual value method. Issue costs in relation to equity instruments were charged to the deficit. The debt component is measured at the issue date as the present value of the cash payments of interest and principal due under the terms at a rate which approximates the estimated interest rate of a similar non-convertible financial instrument with comparable terms and risk. The accounting for convertible notes involves estimates in allocating the proceeds received from issuance of convertible notes between debt and equity components and estimating the expected life of the convertible notes for accretion to face value.

Stock-based compensation is recorded using the fair value based method for stock options issued to employees and non-employees subsequent to July 1, 2002. Under this method, compensation cost is measured at fair value at the date of grant for equity awards and is expensed over the award's vesting period. The Company uses the Black-Scholes options pricing model to calculate stock option values, which requires certain assumptions, including the future stock price volatility and expected time to exercise. Changes to any of these assumptions, or the use of a different option pricing model, could produce different fair values for stock-based compensation, which could have a material impact on the Company's earnings. For awards subject to performance conditions, compensation cost is recognized based on management's best estimate of the outcome of the performance conditions.

Change in functional and reporting currency

As a result of significant changes in the economic facts and circumstances which occurred in 2009, such as changes in the research and development programs and the general business model, delisting from the NASDAQ and deregistration of its shares from the SEC, and obtaining new financing from the 2009 convertible notes and the rights offering in CDN dollars, the Company has determined that the CDN dollar is more accurately reflecting the current and future financial state of the Company. As a result of the above mentioned changes, a significant portion of the Company's expenses, assets, liabilities and financing are denominated in CDN dollars. Therefore, effective January 1, 2010, the Company adopted the CDN dollar as its functional and reporting currency. On January 1, 2010, assets and liabilities as of December 31, 2009, were translated in CDN dollars using the exchange rate in effect on that date, and equity transactions were translated at historical rates. For comparative purposes, historical financial statements were restated in CDN dollars using the current rate method. Under this method, assets and liabilities were translated at the closing rate in effect at the end of the period, revenues, expenses and cash flows were translated at the average rate in effect for the period and equity transactions were translated at historical rates. Any exchange differences resulting from the translation were included in Accumulated other comprehensive income presented in shareholders' deficiency.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In February 2008, Canadian Accounting Standards Board confirmed that Canadian GAAP, as used by publicly accountable enterprises, will be fully converged into International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Therefore, the Company will be required to report under IFRS for its 2011 interim and annual financial statements.

In 2009, the Company began planning the transition from current Canadian GAAP to IFRS by establishing a project plan and a project team. The project team is led by senior finance executives that provide overall project governance, management and support. The project team reports quarterly to the Company's Audit Committee. The project plan consists of three phases: initial assessment, detailed assessment and design, and implementation. The Company has completed the initial assessment phase, which included the completion of a high level review of the major differences between current Canadian GAAP and IFRS, and an initial evaluation of IFRS 1 transition exemptions. The initial assessment included discussions with the Company's external auditors. The Company is in the final stages of completing a comprehensive analysis of the impact of the IFRS differences identified in the initial assessment phase. The design of solutions to resolve these IFRS differences are progressing according to plan.

Set out below are selected key areas of accounting differences where changes in accounting policies in conversion to IFRS may impact the Company's consolidated financial statements. The list and comments should not be construed as a comprehensive list of changes that will result from transition to IFRS, but rather highlights those areas of accounting differences the Company currently believes to be most significant. Notwithstanding, analysis of changes is still in progress and certain decisions remain to be made where choices relating to accounting policies are available. At this stage, the Company is not able to reliably quantify the full impact of these and other differences on the consolidated financial statements mainly due to the impact of the financial instruments.

• Presentation of Financial Statements (IAS 1)

During the last quarter of 2010, the Company has completed its draft IFRS financial statements and related note disclosures to reflect the revised presentation and disclosure requirements under IFRS except for the disclosure in relation to the financial instruments as discussed below

• Financial instruments (IAS 32 and 39)

In accordance with these IFRS standards, financial instruments shall be classified into its component parts upon initial recognition as a financial liability, a financial asset, or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of the financial instruments within these standards. The Company is currently analyzing the allocation of the financial liability and equity components of its financial instruments under IFRS as well as the impact of the refinancing transaction that occurred in 2009. The Company's conclusions are that the 2009 convertible notes, 2007 and 2006 Amended Convertible Notes are hybrid instruments which will be fully classified as a liability with no equity portion; the conversion option will be marked to market to the statement of operations. The Company's conclusion in relation to the outstanding warrants is that they will not meet the criteria for equity classification and will also be fully classified as a liability which will be marked to market to the statement of operations. The Company is currently calculating the impact of the changes in classification and measurement. The Company's conclusion regarding the preferred shares is that there will be no difference with current Canadian GAAP treatment.

• Share Based Payments (IFRS 2)

The Company issues stock-based awards in the form of stock options that vest evenly over a five-year period. Under Canadian GAAP, the Company recognizes the fair value of the award, determined at the time of the grant, on a straight-line basis over the five-year vesting period. Under IFRS, the fair value of each tranche of the award is considered a separate grant based on the vesting period with the fair value of each tranche determined separately and recognized as compensation expense over the term of its respective vesting period. Accordingly, this will result in a higher amount of each grant being recognized as an expense at a faster rate than under Canadian GAAP. The Company intends to restate the stock-based compensation expense under IFRS 2 whereby only unvested options as at January 1, 2010, are restated as required by IFRS 1. The Company has completed the analysis of the stock options under IFRS. An adjustment to compensation expense of $611,000 will be recorded in retained earnings in the IFRS financial statements at January 1, 2010. The compensation expense will then be remeasured during fiscal 2010 and future periods under IFRS.

The Company has determined that the transition to IFRS will not have an impact on the amount of stock-based compensation expense recorded under its deferred share unit plans or incentive compensation agreements.

• Leases (IAS 17)

The Company analyzed the treatment of the sale leaseback transaction under IFRS and concluded that no differences existed from Canadian GAAP.

• Provision (IAS 37)

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, IFRS introduces the concept of an onerous contract which should be recorded as a liability. The Company's lease exit obligation is considered an onerous contract under IFRS. Under IFRS, the discount rate used to determine the provision would be different than under Canadian GAAP and the provision would be remeasured each period with changes in estimates including the applicable discount rate. The Company has completed the analysis of the lease exit obligation under IFRS. The provision will be increased by $883,000 in the IFRS financial statements at January 1, 2010. The lease exit obligation will then be remeasured with the discount rate in effect during fiscal 2010; however, the impact for fiscal 2010 is not expected to be materially different than Canadian GAAP. The Company has completed its assessment of the IFRS impact on the lease exit obligation adjustment recorded in the quarter ended September 30, 2010 under Canadian GAAP as a result of the workforce reduction announced during the quarter ended September 30, 2010. An increase in the provision of $422,000 will recorded in the IFRS financial statements for the period ended September 30, 2010, with lease exit obligation then being remeasured with the discount rate in effect for the remainder of fiscal 2010.

• Change in Functional Currency (IAS 21)

Under IFRS, the Company's change in functional currency, as discussed above, should be accounted for prospectively from the date of change. As at January 1, 2010, all items of the balance sheet will be translated at the foreign exchange rate in effect on that date under IFRS, whereas under Canadian GAAP, assets and liabilities were translated at the exchange rate on January 1, 2010 and equity transactions were translated at historical rates. This difference will result in reclassifications within equity but will not have an impact on the net assets of the Company.

A number of other areas of IFRS will impact the Company as well, albeit to a lesser extent. Other differences between the Company's current and IFRS accounting policies, as well as IFRS accounting policy choices could be identified, but these are currently not expected to have a significant impact on Company's financial statements.

The Company is currently implementing the identified changes to business processes, financial systems, accounting policies, disclosure controls and internal controls over financial reporting. The Company does not expect any significant impact on its business processes, financial systems, disclosure controls and internal controls over financial reporting as a result of change to IFRS.

Based upon the work completed to date, the Company cannot reasonably determine the full impact that adopting IFRS will have on its financial position and future results, mainly due to the impact of the financial instruments. As a result of the transition, changes in accounting policies could have a material impact on the consolidated financial statements.

RISKS AND UNCERTAINTIES

Since its inception in 1993, BELLUS Health has incurred significant operating losses. The Company's pharmaceutical product candidates are in development and none have yet been approved for commercialization by regulatory authorities in any jurisdiction. The Company's business entails significant risks, including the costs and time involved in obtaining the required regulatory approvals, the adequacy of patent protection, the uncertainties involved in clinical testing, the availability of capital to continue development and commercialization of the products, and competition from pharmaceutical, biotechnology and nutraceutical companies.

Significant funding is required for ongoing research and development, clinical trials, marketing, commercial manufacturing of products and the establishment of sales and marketing teams necessary for the launch and ongoing sales of new products. In addition, major financial resources are necessary until such time as the products are commercialized and sold successfully, and sales are sufficient to generate profits. The Company intends to raise additional financing, as required, through research, partnership and licensing agreements, the exercise of stock options and warrants, and through equity and/or debt financing. However, there can be no assurance that these financing efforts will be successful or that the Company will continue to be able to meet its ongoing cash requirements. It is possible that financing will not be available or, if available, may not be on favourable terms.

The availability of financing will be affected by the results of scientific research and clinical development, the Company's ability to obtain regulatory approvals, the market acceptance of the Company's products, the state of the capital markets generally (with particular reference to pharmaceutical, biotechnology, nutraceutical and medical companies), the status of strategic alliance agreements, and other relevant commercial considerations.

Product research and development involves a high degree of risk, and returns to investors are dependent upon successful development and commercialization of the Company's products. A setback in any of the Company's clinical trials may cause a drop in the Company's stock price. Difficulties encountered in enrolling patients in the Company's clinical trials could delay or adversely affect the trials. There can be no assurance that development of any product will be successfully completed or that regulatory approval of any of the Company's products under development will be obtained. Furthermore, there can be no assurance that existing products or new products developed by competitors will not be more effective, or more effectively marketed and sold, than any that may be developed by the Company. There can be no assurance that the Company's future potential products will gain market acceptance among physicians, patients, healthcare payers, the medical community and consumers. In addition, given the very high costs of development of pharmaceutical products, the Company anticipates having to partner with larger pharmaceutical companies to bring pharmaceutical products to market. The terms of such partnership arrangements along with the related financial obligations cannot be determined at this time and the timing of completion of the approval of such products will likely not be within the Company's control.

Because of the length of time and expense associated with bringing new products through development, obtaining regulatory approval and bringing products to market, the Company places considerable importance on obtaining and maintaining patent protection and safeguarding trade secret protection for significant discoveries. There can be no assurance that any pending patent application filed by the Company will mature into an issued patent. Furthermore, there can be no assurance that existing or pending patent claims will offer protection against competition, or will not be designed around or infringed upon by others. Commercial success will also depend in part on the Company not infringing patents or proprietary rights of others. Patent litigation is costly and time consuming and may subject the Company to liabilities.

The Company is currently dependent on third parties for a variety of functions and may enter into future collaborations for the development, manufacture and commercialization of products, including the commercialization of VIVIMIND™. There is no assurance that the arrangements with these third parties will provide benefits the Company expects. There can also be no assurance that the Company will be successful in manufacturing, marketing and distributing products, or that the Company will be able to make adequate arrangements with third parties for such purposes. There can be no assurance that the Company will generate significant revenue or achieve profitability.

A detailed discussion on the Company's risks and uncertainties can be found in the Company's public filings including the Annual Information Form available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

Certain statements included in this MD&A may constitute “forward-looking statements” within the meaning of Canadian securities legislation and regulations, and are subject to important risks, uncertainties and assumptions. This forward-looking information may include among other things, information with respect to the Company’s objectives and the strategies to achieve these objectives, as well as information with respect to the Company’s beliefs, plans, expectations, anticipations, estimates, and intentions. Forward-looking statements generally can be identified by the use of conditional or forward-looking terminology such as “may”, “will”, “expect”, “intend”, “estimate”, “anticipate”, “plan”, “foresee”, “believe” or “continue” or the negatives of these terms or variations of them or similar terminology. Refer to the Company’s filings with the Canadian securities regulatory authorities for a discussion of the various factors that may affect the Company’s future results. Such risks include, but are not limited to: the ability to obtain financing immediately in current markets, the impact of general economic conditions, general conditions in the pharmaceutical and/or nutraceutical industry, changes in the regulatory environment in the jurisdictions in which the BELLUS Health group does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, achievement of the forecasted burn rate, and that actual results may vary once the final and quality-controlled verification of data and analyses has been completed. The results or events predicted in forward-looking information may differ materially from actual results or events. The Company believes that expectations represented by forward-looking statements are reasonable, yet there can be no assurance that such expectations will prove to be correct. Unless otherwise stated, the forward-looking statements contained in this report are made as of the date of this report, and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable legislation or regulation. The forward-looking statements contained in this report are expressly qualified by this cautionary statement.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements have been prepared by management and approved by the Board of Directors of the Company. The consolidated financial statements were prepared in accordance with accounting principles generally accepted in Canada and, where appropriate, reflect management's best estimates and judgments. Where alternative accounting methods exist, management has chosen those methods deemed most appropriate in the circumstances. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality, and for the consistency of financial data included in the text of the Management's Discussion and Analysis with the data contained in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls over financial reporting as described in the Management's Discussion and Analysis.

The Company's Audit Committee is appointed by the Board of Directors annually and is comprised exclusively of outside, independent directors. The Audit Committee meets with management as well as with the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The Audit Committee considers, for review by the Board of Directors and approval by the shareholders, the engagement or reappointment of the independent auditors. The external auditors, KPMG LLP, have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been independently audited by KPMG LLP, Chartered Accountants, on behalf of the shareholders, in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Company.

(Signed) Roberto Bellini,
President and
Chief Executive Officer

(Signed) François Desjardins, C.A.
Vice President, Finance

Laval, Quebec, Canada
March 29, 2011

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INDEPENDENT AUDITORS' REPORT

To the Shareholders

We have audited the accompanying consolidated financial statements of BELLUS Health Inc. (the "Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of operations, comprehensive loss, shareholders' deficiency and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
KPMG Canada provides services to KPMG LLP.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2010 and 2009, and the consolidated results of its operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter - Going Concern

Without qualifying our opinion, we draw attention to note 1 (a) in the consolidated financial statements which indicates that the Company has incurred significant operating losses and negative cash flows from operations since inception and has accumulated deficit of $477,629,000 as at December 31, 2010. These conditions, along with other matters as set forth in note 1 (a), indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Emphasis of Matter - Amendment

Without modifying our opinion, we draw attention to note 9 (a) to the consolidated financial statements which indicates that note 9 (a) to the consolidated financial statements as at and for the year ended December 31, 2010 has been amended.

KPMG LLP*

Chartered Accountants

Montreal, Canada

February 22, 2011, except as to note 9 (a), which is as of March 29, 2011

*CA Auditor permit no 19544

BELLUS HEALTH INC.

Consolidated Balance Sheets

December 31, 2010 and 2009
(in thousands of CDN dollars)

	December 31, 2010	December 31, 2009
		(note 1 (b))
Assets		
Current assets:		
Cash and cash equivalents (note 16 (a))	$ 10,257	$ 14,017
Restricted cash	281	–
Accounts receivable	156	378
Assets held for sale (note 6 (b))	155	–
Research tax credits receivable	1,953	3,618
Prepaid expenses and other assets	712	971
	13,514	18,984
Assets held for sale (note 6 (b))	419	–
Investment in New ABCP Notes (note 4)	6,667	6,918
Restricted cash (note 4)	379	704
Long-term prepaid expenses	–	150
Equipment (note 6 (a))	92	2,595
	$ 21,071	$ 29,351
Liabilities and Shareholders' Deficiency		
Current liabilities:		
Accounts payable	$ 1,241	$ 740
Accrued liabilities	9,701	3,927
Deferred gain on sale of property (note 6 (a))	1,241	6,001
Deferred revenue (note 5 (a))	2,580	–
Current portion of Notes (note 9)	3,678	–
	18,441	10,668
Credit facilities (note 4)	9,789	10,764
Deferred gain on sale of property (note 6 (a))	–	1,351
Deferred revenue (note 5 (a))	6,040	–
Long-term accrued liabilities (note 8)	2,460	8,408
Notes (note 9)	20,937	17,350
	57,667	48,541
Shareholders' deficiency:		
Share capital (note 10)	387,540	386,222
Equity portion of convertible notes	12,901	12,901
Additional paid-in capital	27,442	26,053
Warrants	18,699	18,699
	446,582	443,875
Deficit	(477,629)	(457,516)
Accumulated other comprehensive income	(5,549)	(5,549)
	(483,178)	(463,065)
	(36,596)	(19,190)
Basis of presentation (note 1)		
Commitments and contingencies (note 12)		
Subsequent event (note 21)		
	$ 21,071	$ 29,351

See accompanying notes to consolidated financial statements.

On behalf of the Board of Directors by:

(Signed) Hélène Fortin
Director

(Signed) Pierre Larochelle
Director

BELLUS HEALTH INC.

Consolidated Statements of Operations

Years ended December 31, 2010 and 2009
(in thousands of CDN dollars, except per share data)

	Year ended December 31, 2010	Year ended December 31, 2009
		(note 1 (b))
Revenues (note 5)	$ 2,408	$ (113)
Expenses:		
Research and development	8,464	12,920
Research tax credits and grants	(1,409)	(1,322)
	7,055	11,598
General and administrative	6,466	5,814
Marketing and selling	612	4,360
Stock-based compensation (notes 10 (g) and 11)	1,228	2,646
Depreciation and equipment write-off (notes 6 (a) and (b))	1,466	790
Net expense (credit) for vacant space (note 7 (b) (ii))	272	(2,277)
	17,099	22,931
Loss before undernoted items	(14,691)	(23,044)
Interest income	152	113
Interest and bank charges	(527)	(368)
Accretion expense (notes 9 and 10 (d))	(6,717)	(5,861)
Change in fair value of embedded derivatives (note 9 (a))	19	44
Gain on extinguishment of debt (notes 9 (b) and 10 (d))	–	20,530
Change in fair value of New ABCP Notes (note 4)	663	258
Foreign exchange gain (loss)	988	(462)
	(5,422)	14,254
Net loss	$ (20,113)	$ (8,790)
Net loss per share (note 15):		
Basic	$ (0.10)	$ (0.06)
Diluted	(0.10)	(0.19)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Comprehensive Loss

Periods ended December 31, 2010 and 2009
(in thousands of CDN dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
		(note 1 (b))
Net loss	$ (20,113)	$ (8,790)
Foreign exchange adjustment on change in functional currency (note 1 (b))	–	4,086
Comprehensive loss	$ (20,113)	$ (4,704)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Shareholders' Deficiency

Years ended December 31, 2010 and 2009
(in thousands of CDN dollars)

	Share capital (note 10 (a))	Equity portion of convertible notes	Additional paid-in capital	Warrants	Deficit	Accumulated other comprehensive income	Total
Balance December 31, 2009	$ 386,222	$ 12,901	$ 26,053	$ 18,699	$ (457,516)	$ (5,549)	$ (19,190)
Stock-based compensation (note 11)	–	–	1,389	–	–	–	1,389
Issued on payment of interest on convertible Notes (note 9 (b))	827	–	–	–	–	–	827
Conversion of preferred shares into common shares (note 10 (d))	491	–	–	–	–	–	491
Net loss	–	–	–	–	(20,113)	–	(20,113)
Balance, December 31, 2010	$ 387,540	$ 12,901	$ 27,442	$ 18,699	$ (477,629)	$ (5,549)	$ (36,596)

(note 1 (b))	Share capital (note 10 (a))	Equity portion of convertible notes	Additional paid-in capital	Warrants	Deficit	Accumulated other comprehensive income	Total
Balance December 31, 2008	$ 346,550	$ 11,483	$ 21,237	$ 18,699	$ (444,729)	$ (9,635)	$ (56,395)
Stock-based compensation (note 11)	–	–	1,440	–	–	–	1,440
Equity Portion of 2009 convertible Notes (note 9 (a))	–	12,869	–	–	(627)	–	12,242
Extinguishment of 2006 and 2007 Notes (notes 9 (b) and 10 (c))	–	(11,483)	3,376	–	(2,659)	–	(10,766)
Issuance of 2006 and 2007 Amended Notes (note 9 (b))	–	32	–	–	–	–	32
Issuance of preferred shares (note 10 (d)), net of tax	28,984	–	–	–	(290)	–	28,694
Issued on payment of interest on convertible Notes (note 9 (b))	902	–	–	–	–	–	902
Conversion of preferred shares into common shares (note 10 (d))	99	–	–	–	–	–	99
Issued on exercise of Rights offering (note 10 (c))	9,687	–	–	–	(421)	–	9,266
Foreign exchange adjustment on change in functional currency (note 1 (b))	–	–	–	–	–	4,086	4,086
Net loss	–	–	–	–	(8,790)	–	(8,790)
Balance, December 31, 2009	$ 386,222	$ 12,901	$ 26,053	$ 18,699	$ (457,516)	$ (5,549)	$ (19,190)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2010 and 2009
(in thousands of CDN dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
		(note 1 (b))
Cash flows from operating activities:		
Net loss	$ (20,113)	$ (8,790)
Adjustments for:		
Depreciation and equipment write-off	1,466	790
Unrealized foreign exchange gain	(621)	(386)
Stock-based compensation	1,228	2,646
Accretion expense (notes 7, 9 and 10 (d))	6,903	5,370
Change in fair value of embedded derivatives	(19)	(44)
Gain on extinguishment of debt	–	(20,530)
Net expense (credit) for vacant space	272	(2,277)
Change in fair value of New ABCP Notes	(663)	(258)
Amortization of deferred rent liabilities	944	1,177
Amortization of gain on sale-leaseback	(5,024)	(4,516)
Deferral of lease payments by issuance of promissory notes	2,147	1,541
Settlement of deferred shares units (note 10 (g))	(92)	(78)
Changes in operating assets and liabilities:		
Accounts receivable	222	263
Research tax credits receivable	1,665	(1,855)
Prepaid expenses and other assets	409	336
Accounts payable and accrued liabilities	(1,645)	(4,728)
Deferred revenue (note 5 (a))	8,620	–
	(4,301)	(31,339)
Cash flows from financing activities:		
Credit facilities	(781)	(46)
2009 Notes, net of issue costs (note 9 (a))	–	20,401
Issue costs on 2006 and 2007 notes refinancing (notes 9 (b) and 10 (d))	–	(374)
Common shares issued on exercise of Rights offering (note 10 (c))	–	9,266
	(781)	29,247
Cash flows from investing activities:		
Restricted cash	100	(229)
Additions to equipment	–	(80)
Proceeds from New ABCP Notes (note 4)	761	3,156
Proceeds from sale of assets held for sale (note 6 (b))	463	–
	1,324	2,847
Net (decrease) increase in cash and cash equivalents	(3,758)	755
Cash and cash equivalents, beginning of period	14,017	12,975
Effect of foreign exchange on cash and cash equivalents	(2)	287
Cash and cash equivalents, end of period	$ 10,257	$ 14,017

Supplemental disclosures to cash flow statements (note 16)

See accompanying notes to consolidated financial statements.

1. Organization, business activities, basis of presentation and going concern:

BELLUS Health Inc. (BELLUS Health or the Company) is a development-focused health company concentrating on research and development of products that provide innovative health solutions and address critical unmet medical needs.

Since inception (June 17, 1993), the business activities of the Company have been devoted principally to the development of the Company's core technology platform, amyloid inhibitors, which focus on chemical compounds that could have the potential to inhibit the formation, deposition and toxicity of amyloid fibrils which are implicated or believed to be the underlying causes of certain diseases. The diseases currently targeted by the Company include Amyloid A (AA) amyloidosis as well as Alzheimer's disease. The status of the Company's pharmaceutical product candidates is as follows:

Disease indication	Product candidate	Stage of development
AA amyloidosis	KIACTA™ (eprodisate) [(1)]	Phase III clinical trial
Alzheimer's disease	NRM8499, prodrug of tramiprosate	Phase I clinical trial

[(1)] In 2010, the Company signed an asset sale and license agreement providing for the ongoing development and commercialization of KIACTA™ (eprodisate). See note 5 (a).

The Company was also investigating the efficacy of NC-503 (eprodisate) for the treatment of Type II diabetes and certain features of metabolic syndrome. On May 4, 2010, the Company announced its decision to discontinue the NC-503 (eprodisate) diabetes development program due to lack of efficacy in the Phase II clinical trial.

BELLUS Health is considered to be in the development stage since none of its products have yet to reach commercialization. Since inception, substantially all of the Company's research and development expenditures, capital expenditures, including costs incurred to secure patents, and all revenues from milestone payments, collaboration agreements, research contracts and asset sale, licensing and supply agreements relate to the Company's core technology platform. The Company's research and development expenses since inception amounted to $320,643 as at December 31, 2010.

1. Organization, business activities, basis of presentation and going concern (continued):

To date, the Company has financed its operations primarily through public offerings of common shares, private placements, issuance of convertible notes, as well as a sale-leaseback transaction, research tax credits, collaboration and research contracts, asset sale, licensing and supply agreements, interest and other income. The future operations and profitability of the Company are dependent upon such factors as the success of the clinical trials, the approval by regulatory authorities of products developed by the Company, the ability of the Company to successfully market, sell and distribute products, and the ability of the Company to obtain the necessary financing to complete its projects. In January 2009, the Company delisted its shares from NASDAQ. Additionally, in May 2009, the Company deregistered its securities from the US Securities and Exchange Commission (SEC). The Company's shares trade on the Toronto Stock Exchange (TSX).

(a) Basis of presentation and going concern:

The Company has incurred significant operating losses and negative cash flows from operations since inception and has an accumulated deficit of $477,629 as at December 31, 2010. As at that date, the Company had cash and cash equivalents in the amount of $10,257, mainly as a result of signing an agreement with Celtic Therapeutics (Celtic) during the second quarter of 2010, as described in note 5 (a).

As a result of measures implemented by the Company over the past two years such as reducing its workforce, amending its lease agreement and restructuring its existing debt, as described in notes 7, 9 and 10, the Company has significantly reduced its required cash outflows. As at December 31, 2010, the Company’s committed sources of funds, and the cash and cash equivalents on hand is expected, in management’s view, to be sufficient to meet its committed cash obligations and expected level of expenditures over the next twelve months. However, beyond that, the ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through sale of assets, supply agreements or product licensing agreements, and from obtaining regulatory approval in various jurisdictions to market and sell its product candidates and ultimately achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company’s control. These material uncertainties raise significant doubt about the Company’s ability to continue as a going concern in the foreseeable future.

1. Organization, business activities, basis of presentation and going concern (continued):

(a) Basis of presentation and going concern (continued):

Management continues to pursue additional sources of funds, including through further arrangements relating to the distribution of VIVIMIND™, its natural health brand. While the discussions could lead to the signing of binding agreements in the future, there can be no assurance whatsoever that any such transaction will be put in place. As a result, there is material uncertainty as to whether the Company will have the ability to continue as a going concern for the foreseeable future, and thereby realize its assets and discharge its liabilities in the normal course of business.

The consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. The consolidated financial statements do not include any adjustments to the carrying value and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to receive significant funds on signing collaborative research and development contracts, licensing and supply agreements or by out-licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes (defined in note 4), would be reduced to liquidation value.

(b) Change in functional and reporting currency:

As a result of significant changes in the economic facts and circumstances which occurred in 2009, such as changes in the research and development programs and the general business model, delisting from the NASDAQ and deregistration of its shares from the SEC, and obtaining new financing from the 2009 convertible notes and rights offering in CDN dollars, the Company determined that the CDN dollar more accurately reflects the current and future financial state of the Company. As a result of the above mentioned changes, a significant portion of the Company's expenses, assets, liabilities and financing are denominated in CDN dollars. Therefore, effective January 1, 2010, the Company adopted the CDN dollar as its functional and reporting currency. On January 1, 2010, assets and liabilities as of December 31, 2009, were translated in CDN dollars using the exchange rate in effect on that date, and equity transactions were translated at historical rates. For comparative purposes, historical consolidated financial statements were restated in CDN dollars using the current rate method. Under this method, assets and liabilities were translated at the closing rate in effect at the end of the period, revenues, expenses and cash flows were translated at the average rate in effect for the period and equity transactions were translated at historical rates. The exchange difference resulting from the translation of $5,549 was included in Accumulated other comprehensive income presented in shareholders' deficiency.

2. Significant accounting policies:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

(a) Principles of consolidation:

The consolidated financial statements include the accounts of BELLUS Health and its subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

(b) Cash and cash equivalents:

The Company considers all investments with maturities of three months or less at inception, that are highly liquid and readily convertible into cash, to be cash equivalents.

(c) Equipment:

Equipment is stated at cost. Depreciation is provided at the following annual rates:

Asset	Basis	Rate/period
Research and office equipment	Declining balance	20%
Computer hardware	Declining balance	30%
Computer software	Straight-line	1-2 years

(d) Impairment of long-lived assets:

Long-lived assets, including equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the difference between the carrying amount and the fair value. Quoted market values are used whenever available to estimate fair value. When quoted market values are unavailable, the fair value of the long-lived asset is generally based on estimates of discounted expected net cash flows.

2. Significant accounting policies (continued):

(e) Revenue recognition:

Revenue from the Company's different agreements is assessed in order to determine whether they contain multiple deliverables. Revenue arrangements with multiple deliverables need to be divided into separate units of accounting based on defined accounting criteria. If separation is required, the consideration received or receivable is allocated among the separate units of accounting based on the relative fair values of each unit. If the fair value of the delivered item is not reliably measurable, then revenue is allocated based on the difference between the total arrangement consideration and the fair value of the undelivered item. The applicable revenue recognition criteria are applied to each of the separate units. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting. Payments received under agreements may include upfront payments, regulatory and sales-based milestone payments for specific achievements, distribution fees, as well as revenue from the supply of products. Revenue for each unit of accounting is recorded as follows: (i) non-refundable upfront payments received on the signing of agreements and regulatory milestone payments, which require the Company's ongoing involvement, are deferred and amortized into income on a straight-line basis over the expected period of performance of the related activities, provided that revenue subject to the achievement of milestones is recognized only when the specified events have occurred and collectability is reasonably assured; (ii) sales-based milestone payments, for which the Company has no future involvement or obligations to perform related to that specified element of the arrangement, are recognized into income upon the achievement of the specified milestones and when collectability is reasonably assured; (iii) distribution fees are recognized when the service has been performed, the amount is determinable and collection is reasonably assured; and (iv) revenue from the supply of products is recognized in accordance with the Company's policy below.

Amounts received or billed in advance of recognition are shown as deferred revenue.

Revenues from the sale or supply of products are recognized when persuasive evidence of an arrangement exists, the product has been delivered, there are no future performance obligations, the selling price is fixed and determinable, and collection is reasonably assured. Sales allowances for products returns and cooperative promotional incentives are recorded at the time sales are recognized as a reduction of revenue.

Interest income is recognized using the effective interest method.

2. Significant accounting policies (continued):

(f) Research and development:

Research expenditures are expensed as incurred and include a reasonable allocation of overhead expenses. Development expenditures are deferred when they meet the criteria for capitalization in accordance with GAAP, and that the assets will generate probable future economic benefits. As at December 31, 2010 and 2009, no development costs were deferred. On January 1, 2009, the Company adopted the new accounting standards issued by the CICA, Section 3064, *Goodwill and Intangible assets* and Section 3450, *Research and Development costs*. As a result of the adoption of these standards, direct costs incurred to secure patents related to internally-generated assets are no longer capitalized by the Company. The Company applied the standards on a retrospective basis.

(g) Government assistance:

Government assistance, consisting of grants and research tax credits, is recorded as a reduction of the related expense or cost of the asset acquired. Grants are recorded when there is reasonable assurance that the Company has complied with the terms and conditions of the approved grant program. Research tax credits recorded are those in management's belief for which there is reasonable assurance of their recovery. Research tax credits claimed for the current and prior years are subject to current government review which could result in adjustments to earnings.

(h) Foreign exchange:

Monetary assets and liabilities denominated in foreign currencies are translated at year-end exchange rates. Non-monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the transaction date. Income and expenses denominated in foreign currencies are translated at exchange rates in effect at the transaction date. Translation gains and losses are included in income.

(i) Income taxes:

Income taxes are provided for using the liability method. Under this method, differences between the financial reporting bases and the income tax bases of the Company's assets and liabilities are recorded using the substantively enacted tax rates anticipated to be in effect when the tax differences are expected to reverse. A valuation allowance is recorded against any future tax asset if it is not more likely than not that the asset will be realized.

(j) Costs associated with lease exit activities:

Costs associated with lease obligations for leased premises that are no longer being used by the Company are recognized and measured at fair value as of the cease-use date. The fair value of the liability at the cease-use date is determined based on the remaining lease rentals, reduced by estimated sublease rentals that could reasonably be obtained for the property, measured using the credit-adjusted risk-free rate.

2. Significant accounting policies (continued):

(k) Earnings per share:

Basic earnings per share are determined using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed in a manner consistent with basic earnings per share, except that the weighted average number of shares outstanding is increased to include additional shares from the assumed exercise of options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding options and warrants were exercised, and that the proceeds from such exercises were used to acquire common shares at the average market price during the reporting period. The dilutive effect of the convertible notes is reflected in diluted earnings per share by application of the "if-converted" method, if dilutive. Under the if-converted method, convertible notes are assumed to have been converted at the beginning of the period (or at time of issuance, if later) and the resulting common shares are included in the denominator for purposes of calculating diluted earnings per share.

(l) Stock-based compensation:

The Company follows the fair value based method to account for options granted to employees whereby compensation cost is measured at fair value and is expensed over the award's vesting period. For awards subject to performance conditions, compensation cost is recognized based on management's best estimate of the outcome of the performance conditions. Options granted to non-employees are remeasured at fair value at each balance sheet date until vested.

(m) Financial instruments:

The Company has designated its financial instruments as follows:

Cash and cash equivalents and restricted cash are classified as "Financial Assets Available for Sale". These financial assets are marked-to-market at each reporting date with all unrealized gains and losses recognized in comprehensive income. Other-than-temporary impairment losses on these financial assets are recognized in income.

Investments in New ABCP Notes are classified as "Held for Trading". These financial assets are remeasured at each reporting date at fair value with all gains and losses recognized in income.

Accounts receivable are classified as "Loans and Receivables". Accounts payable, accrued liabilities and notes are classified as "Other Financial Liabilities". After their initial fair value measurement, these financial instruments are measured at amortized cost using the effective interest rate method.

2. Significant accounting policies (continued):

(m) Financial instruments (continued):

Derivative instruments are recorded as either assets or liabilities measured at their fair value each period through earnings unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. Embedded derivatives are required to be separated from the host contract and accounted for as a derivative financial instrument if the embedded derivative and host contract are not closely related, and the combined contract is not held for trading or designated at fair value.

Transactions costs are capitalized to the cost of financial assets and liabilities when they are not classified as held for trading. Thus, financing costs relating to notes are classified as a reduction in notes and are being amortized using the effective rate method over the life of the related debt.

(n) Use of estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant areas requiring the use of management estimates include estimating the useful lives and recoverability of equipment, estimating accruals for clinical trial expenses, allocating the consideration to the multiple elements, estimating the timing of regulatory approvals, and the pattern of performance for revenue recognition purposes, estimating the provision for sales returns and allowances, estimating the fair value of investment in New ABCP Notes, allocating the proceeds received from issuance of convertible notes between debt and equity components, estimating the expected life of the convertible notes as well as assessing the acceptance by the government agencies of investment tax credit claims made by the Company and the recoverability of research tax credits. The reported amounts and note disclosures reflect management's best estimate of the most probable set of economic conditions and planned course of actions. Actual results could differ from these estimates.

3. Changes in accounting policies:

Future accounting changes:

International Financial Reporting Standards:

In February 2008, the AcSB confirmed that GAAP, as used by publicly accountable enterprises, will be fully converged into International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Therefore, the Company will be required to report under IFRS for its 2011 interim and annual consolidated financial statements.

4. Investment in New ABCP Notes:

In 2007, the Canadian third party asset-backed commercial paper (ABCP) market was hit by a liquidity disruption. In 2007, a Pan-Canadian Investors Committee (the Committee) was established to oversee the restructuring of these instruments. In 2009, the Company received the following new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP, pursuant to the terms of the restructuring plan announced by the Committee : $2,306 of MAV2 Class A-1 Notes, $2,773 of MAV2 Class A-2 Notes, $503 of MAV2 Class B Notes, $173 of MAV2 Class C Notes, $850 of MAV2 IA Tracking Notes, US$5,000 of MAV3 IA Tracking Notes, as well as US$977 and $985 of MAV3 TA Tracking Notes. The legal maturity of the New ABCP Notes is July 15, 2056, but the actual repayment date is expected to be in 2017. As at December 31, 2010, the Company held New ABCP Notes having a principal value of $7,027 and US$3,635. During the year ended December 31, 2010, the Company received partial payments for capital of $738, and for accrued interest of $23 (2009 - $2,436 and $720, respectively). The Company has not recorded any interest income since the initial maturity of the ABCP it held, as the expected interest proceeds were considered in the determination of the fair value of the New ABCP Notes.

4. Investment in New ABCP Notes (continued):

On April 20, 2009, in connection with the restructuring of the ABCP market, the Company entered into new secured revolving credit facilities with the chartered bank that sold the ABCP to the Company, with a minimum 2-year term and with options to renew on an annual basis for up to a maximum total potential term of seven years. As of December 31, 2010, these new credit facilities have combined maximum aggregate amounts of approximately $9,789 (2009 - $10,856, of which $92 was not drawn), bear interest at prime rate minus 1% per annum (weighted average effective interest rate was 2.02% in 2010 (2009 - 2.0%)), and are secured by hypothecs having an aggregate principal amount of $18,400 on New ABCP Notes issued to the Company, on the securities accounts in which they are held and on all proceeds of these notes. The amount of these new credit facilities decreases as capital payments are received on the New ABCP Notes. In addition, a portion of these facilities and all other obligations of the Company towards the chartered bank are secured by a hypothec on the universality of the Company's assets in the amount of approximately $2,000. The revolving credit facilities also include a put option feature which may limit the Company's losses to between 25% and 55% of the New ABCP Notes, subject to certain conditions.

4. Investment in New ABCP Notes (continued):

As at December 31, 2010, the Company estimated the fair value of the outstanding balance of the New ABCP Notes at approximately $7,046, of which $379 is presented as long-term Restricted cash in the consolidated balance sheet, as it is pledged to a bank as collateral for a letter of credit issued in connection with a lease agreement. In connection with its fair value determinations, the Company recorded an increase in fair value of $663 for the year ended December 31, 2010 (2009 - increase of $258). The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.80% (weighted average rate of 0.58%), depending on the series of the New ABCP Notes. These future cash flows were discounted, according to the series, over a period of up to 7 years and using discount rates ranging from 2.98% to 7.75% (weighted average rate of 6.35%). The Company also took into account the put option feature included in the credit facilities in determining the change in fair value of the New ABCP Notes recognized in earnings. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2010, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company’s current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

5. Revenues:

Revenues consist of:

		2010		2009
Asset sale, licensing and supply agreements ((a) and (b))	$	2,218	$	–
Net product sales		190		(113)
	$	2,408	$	(113)

(a) Asset sale and licensing:

On April 29, 2010, the Company entered into an asset sale and license agreement pursuant to which Celtic acquired and licensed worldwide rights related to the Phase III investigational product candidate KIACTA™ (eprodisate) for upfront payments totalling US$10,000, to be paid in two instalments of US$5,000. On April 29, 2010, the Company received proceeds of $5,027 (US$5,000), and received the second tranche of $5,012 (US$5,000) on November 4, 2010. The Company also transferred related research inventory for proceeds of $173 (US$172) in conjunction with this agreement.

Celtic will fund 100% of KIACTA™'s development costs through its confirmatory Phase III clinical study and all other requirements for KIACTA™'s regulatory approval. Celtic will then conduct an auction process for the commercialization rights of KIACTA™. Ultimately, the overall proceeds of the auction process are expected to be shared equally between Celtic and the Company. In conjunction with the asset sale and license agreement, a service agreement has been signed for an expected amount of US$745 receivable over the life of the agreement. Under this agreement, the Company will provide support and assistance to Celtic in connection with their development plan concerning KIACTA™.

The Company has determined that deliverables related to the upfront payments and other monetary considerations under both agreements do not meet the requirements for separation and, as such, accounts for them as a single unit of accounting for revenue recognition. Revenue is recognized on a straight-line basis over the development phase conducted by Celtic (estimated to be 49 months to May 31, 2014), as that time period is considered to be management's best estimate of the pattern of performance of all deliverables. The Company recognized revenues of $1,805 for the year ended December 31, 2010, and deferred revenue amounts to $8,620 as at December 31, 2010, of which $2,580 is classified as a current liability.

Transaction costs are presented in General and administration expenses in the consolidated statement of operations.

5. Revenues (continued):

(b) License and supply agreements:

(i) On October 19, 2010, the Company, with the approval of a Special Committee of the Board of Directors, signed a license and supply agreement relating to the distribution of VIVIMIND™ in Italy with FB Health LLC (FB Health). Pursuant to the license and supply agreement, the Company granted FB Health exclusive distribution rights for VIVIMIND™ in Italy, for a consideration consisting primarily of up to €3,000 in commercial milestone payments should certain mutually agreed upon sales targets be achieved. The license and supply agreement also provided for BELLUS Health to supply material for the product to FB Health at a pre-agreed transfer price. Regulatory approval for the sale of VIVIMIND™ in Italy for memory function protection and the maintenance of cognitive health was granted in 2009. FB Health is an Italian nutraceutical company controlled by Dr. Francesco Bellini, Chairman of the Board of Directors of BELLUS Health.

The Company received $63 during the fourth quarter of 2010 in connection with this agreement, recognized as revenue in 2010. The Company has no further obligations towards FB Health other than the ongoing supply of material, determined to be at fair value. The milestone payments, contingent upon the completion of the pre-established sales targets, will be recognized as revenue when the sales targets are achieved. As management has determined that the price of the material that BELLUS Health will be supplying FB Health represents fair value, sales of material will be recorded at the time the product will be delivered, no future performance obligations exist, and collection is reasonably assured.

(ii) On December 31, 2010, the Company entered into a share purchase agreement with Advanced Orthomolecular Research Inc (AOR) for the shares of OVOS Natural Health Inc. (OVOS), the Company's wholly-owned neutraceutical Canadian subsidiary. In addition, the Company and AOR entered into an exclusive license and supply agreement relating to the distribution of VIVIMIND™ in Canada. Pursuant to the share purchase agreement, AOR acquired all issued and outstanding shares of OVOS for a total consideration of $1,000, consisting of an upfront payment of $350 and of a payment of $650 contingent upon the successful completion of a pre-established milestone event, expected to occur within 18 months of the closing of the transaction. Pursuant to the license and supply agreement, the Company granted AOR exclusive distribution rights for VIVIMIND™ in Canada and will be supplying AOR with material for the product at a pre-agreed transfer price. The license and supply agreement also provides for up to $3,000 in commercial milestone payments to BELLUS Health should certain mutually agreed upon sales targets be achieved.

5. Revenues (continued):

(b) License and supply agreements (continued):

(ii) (continued):

The Company has recorded the $350 upfront payment as revenue for the year ended December 31, 2010. The Company has no further obligations towards AOR other than the ongoing supply of material, determined to be at fair value. The remaining $650, as well as the milestone payments contingent upon the completion of the pre-established sales targets, will be recognized as revenue when the sales targets are achieved. As the price of the material that BELLUS Health will be supplying AOR represents fair value, sales of material will be recorded at the time the product will be delivered, no future performance obligations exist, and collection is reasonably assured.

6. Equipment:

(a) Equipment consists of:

			2010
	Cost	Accumulated depreciation	Net book value
Research equipment (b)	$ –	$ –	$ –
Computer hardware and software	1,900	1,853	47
Office equipment (b)	150	105	45
	$ 2,050	$ 1,958	$ 92

			2009
	Cost	Accumulated depreciation	Net book value
Research equipment	$ 7,943	$ 5,972	$ 1,971
Computer hardware and software	3,491	3,138	353
Office equipment	954	683	271
	$ 12,388	$ 9,793	$ 2,595

For the year ended December 31, 2010, the Company recorded a depreciation expense totaling $448 (2009 - $790).

6. Equipment (continued):

(a) (continued):

On November 17, 2005, the Company entered into a sale and leaseback transaction for its facilities for a sale price of $32,000. The transaction generated a net gain of $21,358. The net gain is deferred and is being amortized over the modified term of the lease as a reduction of rent expense (refer to note 7 (b) (i)). Rent expense is calculated on a straight-line basis over the modified term of the lease.

(b) Assets held for sale

In connection with the restructuring announced on August 9, 2010 (see note 7 (a)), the Company has implemented a plan to sell its excess research and office equipment. The Company has sold a portion of the equipment as at December 31, 2010, and intends to sell the remaining equipment within the next three months. Long-lived assets classified as held for sale are measured at the lower of their carrying amount or fair value less costs to sell, and are not amortized. An impairment loss of $1,018 on the measurement of the assets held for sale has been included in Depreciation and equipment write-off in the consolidated statement of operations.

7. Restructuring charges:

(a) Workforce reduction:

On August 9, 2010, the Company announced that it will gradually reduce its workforce by more than two thirds, to focus on supporting its current and future strategic partnerships and on undertaking less expensive product development programs for NRM8499 to extend its cash resources. The one-time costs associated with this reduction, totaling approximately $1,655, were expensed in the third quarter of 2010. These costs are presented on the following lines in the consolidated statement of operations: Research and development ($880) and General and administrative ($775). As at December 31, 2010, the provision related to the workforce reduction amounts to $1,188, and is presented in Accrued liabilities in the consolidated balance sheet. The balance of $467 was paid during the year ended December 31, 2010.

7. Restructuring charges (continued):

(a) Workforce reduction (continued):

During the first quarter of 2009, the Company reduced its research activities and associated workforce to focus on its key projects. The one-time costs associated with this reduction, totaling approximately $898, were expensed and paid in the first half of 2009. These costs are presented on the following lines in the consolidated statement of operations: Research and development ($449), General and administrative ($392) and Marketing and selling ($57). As a result of the restructuring, the terms of certain stock options were modified to prolong the life of the options which would have otherwise ended on termination for certain employees and Directors. These modifications did not have a significant impact on the consolidated financial statements of the Company.

(b) Lease of premises:

As a result of the restructuring of its activities during the first quarter of 2009, the Company occupied approximately two thirds of the premises it initially occupied under a lease that was to expire in 2020. In addition, in August 2010, the Company further reduced its workforce and the portion of the premises occupied.

(i) Amendment to lease:

As a condition precedent to the 2009 Notes financing, the landlord of the Company's premises in Laval, Quebec, agreed, effective April 1, 2009, to amend the lease. As part of the amendment, the Company had the option to terminate the lease in January 2011, effective April 7, 2011 (Termination Option), which was exercised on January 14, 2011 (refer to note 21).

In addition, as part of the lease amendment, the Company deferred the payment of its base rent by $167 per month minus any sublease revenue from April 1, 2009 to April 7, 2011 (the Deferred Rent). The Deferred Rent bears interest at the rate of ten percent (10%) annually, calculated from the first date of the month when any such component of Deferred Rent becomes due and payable. Deferred Rent and the accrued interest thereon are evidenced by promissory notes issued by BELLUS Health to its landlord on the first day of each month when such Deferred Rent becomes due. The promissory notes are payable in cash or, at the option of BELLUS Health, through the issuance of common shares at the market price on the day on which the notes become payable. Deferred Rent and all notes evidencing Deferred Rent shall be payable on April 7, 2011 in cash or, at the Company's option, through an issuance of common shares from treasury. The promissory notes are financial liabilities classified as short-term Notes in the consolidated balance sheet; therefore, after initial recognition at fair value, they are accounted for at amortized cost (refer to note 9).

7. Restructuring charges (continued):

(b) Lease of premises (continued):

(i) Amendment to lease (continued):

The Company has determined that the Termination Option constitutes a material modification to the terms of the original lease. It has concluded that the lease should continue to be classified as operating and that the lease term for accounting purposes will end in April 2011. Accordingly, the deferred gain on sale of property and the deferred rent liability, recorded in 2005 at the time of the sale leaseback transaction on the Company's premises, are amortized on a straight-line basis to April 2011 for the portion of the premises that the Company continues to occupy. A portion of the deferred gain on sale of property and deferred rent liability has been attributed to the premises no longer occupied by the Company and factored into the net credit or expense for vacant space described in (ii) below.

(ii) Vacant space:

The reduction of the Company's research activities and associated workforce during the first quarter of 2009, as described above, resulted in vacant space in the Company's premises. For the year ended December 31, 2009, the Company recorded a net credit for vacant space in the amount of $2,277.

This amount includes:

- A provision for lease consisting of future lease costs of the vacant portion of the premises, net of an estimate of the sublease rentals that could reasonably be obtained, as well as an amount proportionate to the vacant space of the lease Termination Option payment ($2,340).

Less:

- An amount of the deferred gain on sale of property in proportion to the vacant space ($4,261), and
- An amount of the deferred rent liability in proportion to the vacant space ($356).

7. Restructuring charges (continued):

(b) Lease of premises (continued):

(ii) Vacant space (continued):

During the third quarter of 2010, the additional reduction of the Company's research activities and associated workforce resulted in additional vacant space in the Company's premises. As a result, the Company recorded a net expense for vacant space in the third quarter of 2010, in the amount of $272.

This amount includes:

- A provision for lease consisting of future lease costs of the vacant portion of the premises, net of an estimate of the sublease rentals that could reasonably be obtained, as well as an amount proportionate to the vacant space of the lease Termination Option payment ($584).

Less:

- An amount of the deferred gain on sale of property in proportion to the vacant space ($281), and
- An amount of the deferred rent liability in proportion to the vacant space ($31).

The net credit and net expense for vacant space were determined on the basis of the net present value of foregoing items over the remaining lease period. The net expense accretion on the foregoing items for the year ended December 31, 2010, amounted to $186 (2009 – net credit accretion of $491) and is presented in General and administrative expenses in the consolidated statement of operations. The estimate is based on various assumptions, including the Company's estimated borrowing rate of 41.02% and obtainable sublease rates. These assumptions are influenced by market conditions and the availability of similar space in the area. If market conditions change for sublease rentals in the future, the Company will adjust the provision accordingly.

7. Restructuring charges (continued):

(b) Lease of premises (continued):

(ii) Vacant space (continued):

Changes in the provision for the years ended December 31, 2010 and 2009 are as follows:

	Provision for lease
Initial provision	$ 2,143
Adjustment to provision	197
Payments	(948)
Accretion expense	732
Foreign exchange loss	297
Balance as at December 31, 2009 (including a short-term portion of $184)	2,421
Adjustment to provision	584
Payments	(1,278)
Accretion expense	1,059
Balance as at December 31, 2010	$ 2,786

8. Long-term accrued liabilities:

Long-term accrued liabilities consist of:

	2010	2009
Lease exit obligation (note 7) [1]	$ –	$ 2,237
Deferred rent liability [1]	–	2,218
Deferred share unit plan (note 10 (g))	880	1,133
Advance from a government agency	112	127
Debt component of preferred shares (note 10 (d)) [2]	1,468	2,693
	$ 2,460	$ 8,408

[1] Lease exit obligation and deferred rent liability are presented in Accrued liabilities in the consolidated balance sheet as at December 31, 2010 as the lease will be terminated in April 2011, and amount to $2,786 and $3,031, respectively.

[2] Debt component of preferred shares also includes an amount of $979 presented in Accrued liabilities.

9. Notes:

Notes consist of the following:

	Face value	Carrying value	
	December 31, 2010	December 31, 2010	December 31, 2009
15% Senior convertible notes due in 2014 (2009 Notes) (a)	$ 21,115	$ 13,306	$ 9,353
6% Senior convertible notes due in 2026 (2006 Amended Notes) (b)	12,930	6,990	5,856
6% Senior convertible notes due in 2027 (2007 Amended Notes) (b)	497	288	238
Derivative-related liability (a)	–	353	372
Deferred Rent promissory notes (note 7 (b) (i))	3,678	3,678	1,531
Notes as at December 31, 2010	38,220	24,615	17,350
Current portion – Deferred Rent promissory notes	(3,678)	(3,678)	–
Long-term portion	$ 34,542	$ 20,937	$ 17,350

(a) Amended:

On April 16, 2009 and June 3, 2009, the Company issued for cash $20,500 convertible notes (the 2009 Notes) to Vitus Investments III Private Limited (Vitus), a corporation whose shares are beneficially owned by Mr. Carlo Bellini ($10,000), and Victoria Square Ventures Inc. (VSVI), a subsidiary of Power Corporation of Canada ($10,500) (together with Vitus, the Investors). The aggregate amount of the 2009 Notes issued to the Investors was increased by $615 to cover a setup fee in connection with the financing.

9. Notes (continued):

(a) Amended (continued):

The 2009 Notes are secured, subject to certain permitted encumbrances, by a first charge on all of the assets of BELLUS Health and certain of its subsidiaries. Interest is capitalized on the 2009 Notes at the rate of 15% per year, compounded annually, and the notes and capitalized interest mature April 2014. At maturity, capital and interest are payable in cash or common shares of BELLUS Health, at the option of the holder, at an initial price of $0.20 (the Financing Conversion Price). The 2009 Notes include customary anti-dilution provisions in respect of issuances of securities or distributions to shareholders and, in the event BELLUS Health issues additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, “full ratchet” anti-dilution protection (which will have the effect of lowering the Financing Conversion Price to the new issue price of equity or equity-linked securities) applies, subject to certain exceptions. Following issuance of the Company’s common shares in September 2009 in relation to a rights offering (refer to note 10 (c)), the Financing Conversion Price has been adjusted to $0.185. In addition, following issuance of the Company’s common shares in November 2010 in relation to interest payment on the 2006 and 2007 convertible notes, the Financing Conversion Price has been further adjusted to $0.077 (the Adjusted Financing Conversion Price). The 2009 Notes contain adjustment provisions in the event of a change of control, negative covenants, as well as a pre-emptive right in respect of future financings of BELLUS Health. The 2009 Notes issued to VSVI contain certain piggyback rights in favour of VSVI. The exercise of pre-emptive and piggyback rights is subject to regulatory approval. The Company has amended the previously-disclosed Financing Conversion Price to reflect the impact of the November 2010 issuance of common shares which resulted in the Adjusted Financing Conversion Price being $0.077.

The 2009 Notes are accounted for as a compound financial instrument and are presented in their component parts of debt and equity. The Company allocated the proceeds from the 2009 Notes between its liability and equity components using the residual value method. The 2009 Notes proceeds were allocated as follows: $7,721 to debt, net of issue costs of $400, $12,869 to equity portion of the convertible notes and $438 to derivative-related liability. Issue costs of $627 in relation to equity instruments were charged to the deficit. The debt component is measured at the issue date as the present value of the cash payments of interest and principal due under the terms at a rate which approximates the estimated interest rate of a similar non-convertible financial instrument with comparable terms and risk. The fair value of the embedded derivatives was determined using the Binomial model. The difference between the debt components and the face value of the 2009 Notes has been allocated to equity. The models used in the valuation of the components of the convertible notes contain certain subjective assumptions, changes to which would have cause significant variation in the estimated fair value of the debt and equity components of the convertible notes.

9. Notes (continued):

(a) Amended (continued):

The Company accretes the carrying value of the 2009 Notes to their face value through a charge to earnings over their expected life, which is 60 months. The unrecognized accretion expense on the 2009 Notes amounted to $29,171 as at December 31, 2010, and will be recognized over the remaining expected life of 39 months. Any adjustment will be recognized as income or expense in net earnings. The effective interest rate of the 2009 Notes is 35.79%.

Changes in the 2009 Notes and derivative-related liability for the years ended December 31, 2010 and 2009 were as follows:

	2009 Notes	Derivative-related liability
Issuance of 2009 Notes	$ 7,721	$ 438
Accretion expense	1,920	–
Change in fair value	–	(44)
Foreign exchange gain	(288)	(22)
Balance as at December 31, 2009	9,353	372
Accretion expense	3,953	–
Change in fair value	–	(19)
Balance as at December 31, 2010	$ 13,306	$ 353

(b) In connection with and as a condition to the 2009 Notes financing, BELLUS Health and all of the existing noteholders agreed, in order to reduce cash interest payments, to amend the terms of the outstanding 2006 Notes and 2007 Notes (the Original Notes). Holders of US$29,085 principal amount of 2006 Notes and US$4,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into preferred shares in the authorized capital of BELLUS Health. Refer to note 10 (d).

Holders of US$13,000 principal amount of the 2006 Notes and one remaining holder of US$500 principal amount of the 2007 Notes agreed to amend the terms of their notes (the Amended Notes), without immediate conversion into preferred shares. The amendments include providing for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of BELLUS Health at the then market price of the common shares, and replacing the conversion rate adjustment period and redemption dates. Amendments to the notes also include the removal of certain negative covenants.

9. Notes (continued):

(b) (continued):

The following are terms of the 2006 Amended Notes. Any principal not converted is to be paid upon maturity in 2026. The 2006 Amended Notes are convertible into common shares based on a modified conversion rate of 62.3974 shares per US$1 principal amount of the notes (US$16.03 per share, see note 10 (c)). The 2006 Amended notes are convertible, at the option of the holder, under the following conditions:

(i) if the closing sale price of the Company's common shares for each of 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter exceed 120% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter;

(ii) during the five consecutive business days immediately after any five consecutive trading day period in which the average trading price per US$1 principal amount of 2006 Amended Notes was equal to or less than 97% of the average conversion value of the 2006 Amended Notes;

(iii) if the Company makes certain distributions on its common shares or engages in certain transactions;

(iv) at anytime from, and including October 15, 2012 to November 15, 2012, and at anytime on or after November 15, 2021.

On October 15, 2012, the conversion rate of the 2006 Amended Notes will be adjusted to an amount equal to a fraction whose numerator is US$1 and whose denominator is the average of the closing sale prices of the common shares during the 20 trading days immediately preceding, and including, the third business day immediately preceding October 15, 2012. However, no such adjustment will be made if the adjustment will reduce the conversion rate. On and after November 15, 2012, the conversion rate will be readjusted back to the conversion rate that was in effect prior to October 15, 2012.

The holders have the right to have BELLUS Health redeem the 2006 Amended Notes on each of January 17, 2014, November 15, 2014, November 15, 2016 and November 15, 2021, at a purchase price in cash equal to 100% of the then face value of the 2006 Amended Notes, plus accrued and unpaid interest.

On or after November 15, 2011, the Company may redeem the 2006 Amended Notes, in whole or in part, at a redemption price in cash equal to 100% of the principal amount of the 2006 Amended Notes, plus any accrued and unpaid interest.

The Company, at its discretion, may elect to settle the principal amount owing upon redemption or conversion in cash, shares or a combination thereof.

9. Notes (continued):

(b) (continued):

The following are terms of the 2007 Amended Notes. Any principal not converted is to be paid upon maturity in 2027. The 2007 Amended Notes are convertible at the option of the holder into fully paid and nonassessable common shares at anytime on or after April 16, 2010, based on a conversion price of US$0.975 per share. The conversion price may be fixed, subject to shareholder's approval, for the period from, and including, October 15, 2012, to, and including, November 15, 2012. At the option of the holder, the Notes potentially may be repurchased by BELLUS Health on January 17, 2014 and November 15, 2014, at a purchase price in cash equal to 100% of the then face value of the 2007 Amended Notes, plus accrued and unpaid interests.

In accordance with GAAP, the amendment of the Original Notes into the Amended Notes was accounted for as an extinguishment of the Original Notes. The difference between the fair value of the Amended Notes over the book value of the Original Notes and related embedded derivatives resulted in a gain on extinguishment of debt in the amount of $7,530 in the consolidated statement of operations, net of a loss of $151 on settlement of the 2007 Original Notes embedded derivative asset. The fair value of Amended Notes was determined by using a probability weighted average of cash flows under the terms of the Amended Notes using a rate of 41.02%. Concurrently, the equity portion of the Original Notes in the amount of $3,376 was reclassified to additional paid-in capital. The Amended Notes were accounted for as compound financial instruments with both a debt and an equity component. The debt component in the amount of $6,080, net of issue costs of $62, was measured at the amendment date as the present value of the interest and principal payments, while the residual amount of $32 was allocated to the equity component.

The Company accretes the carrying value of the 2006 and 2007 Amended Notes to their face values through a charge to earnings over their expected lives, which are 48 and 44 months, respectively. As at December 31, 2010, the unrecognized accretion expense amounted to $7,719 for the 2006 Amended Notes and $268 for the 2007 Amended Notes and will be recognized over the remaining expected lives of 27 and 23 months, respectively, assuming no conversion during that period. The effective interest rate is 35.61% for the 2006 Amended Notes and 36.34% for the 2007 Amended Notes.

9. Notes (continued):

(b) (continued):

Changes in the 2006 Notes, 2007 Notes and derivative-related asset for the years ended December 31, 2010 and 2009 were as follows:

	2006 Notes	2007 Notes	Derivative-related asset
Original Notes:			
Balance as at December 31, 2008	$ 43,396	$ 3,855	$ (1,373)
Accretion expense	1,619	229	–
Interest paid/payable	(908)	(99)	–
Extinguishment	(43,439)	(3,925)	1,373
Foreign exchange gain	(668)	(60)	
	–	–	–
Amended Notes:			
Issuance of Amended Notes	5,845	235	–
Accretion Expense	1,403	51	–
Interest paid/payable	(621)	(15)	–
Foreign exchange gain	(771)	(33)	
Balance as at December 31, 2009	5,856	238	–
Accretion Expense	2,288	96	–
Interest paid/payable	(793)	(31)	–
Foreign exchange gain	(361)	(15)	
Balance as at December 31, 2010	$ 6,990	$ 288	$ –

During the year ended December 31, 2010, accrued and unpaid interest due on the 2006 and 2007 Amended Notes of $796 and $31, respectively, were paid via the issuance of 7,517,258 common shares, at the then market price of the shares (during the year ended December 31, 2009, accrued and unpaid interest due on the 2006 and 2007 Original and Amended Notes of $869 and $33, respectively, were paid via the issuance of 3,431,794 common shares, at the then market price of the shares)

The terms of the 2009 Notes and of the Amended Notes require the continued listing of the Company's shares on the TSX; failure to meet this requirement would be an event of default which may result in the convertible notes becoming immediately due and payable.

10. Share capital:

(a) The authorized share capital of the Company consists of:
- an unlimited number of voting common shares
- an unlimited number of non-voting preferred shares, issuable in one or more series

(b) Issued and outstanding shares are as follows:

	Common shares		Preferred shares		Total
	Number	Dollars	Number	Dollars	Dollars
Balance December 31, 2009	110,439,105	$ 358,428	97,831,160	$ 27,794	$ 386,222
Issued on payment of interest on convertible Notes (note 9 (b))	7,517,258	827	–	–	827
Conversion of preferred shares into common shares (d)	20,554,365	5,060	(18,620,000)	(4,569)	491
Balance December 31, 2010	138,510,728	$ 364,315	79,211,160	$ 23,225	$ 387,540

	Common shares		Preferred shares		Total
	Number	Dollars	Number	Dollars	Dollars
Balance December 31, 2008	50,043,892	$ 346,550	–	$ –	$ 346,550
Issued on payment of interest on convertible Notes (note 9 (b))	3,431,794	902	–	–	902
Issued on conversion of 2006 and 2007 Notes, net of tax (d)	–	–	102,431,160	28,984	28,984
Conversion of preferred shares into common shares (d)	4,600,000	1,289	(4,600,000)	(1,190)	99
Issued on exercise of Rights offering (c)	52,363,419	9,687	–	–	9,687
Balance December 31, 2009	110,439,105	$ 358,428	97,831,160	$ 27,794	$ 386,222

10. Share capital (continued):

(c) Common shares:

On September 10, 2009, the Company completed a $9,687 rights offering and issued a total of 52,363,419 common shares at a price of $0.185 per share (the Subscription Price). Financing fees of $421 have been charged to the deficit. Under the rights offering, rights were exercised to subscribe for 9,120,177 common shares at the Subscription Price for proceeds of $1,687. At the same time, in accordance with the terms of the stand-by purchase agreements entered into by BELLUS Health with the Investors, each of Vitus and VSVI subscribed for 21,621,621 common shares of BELLUS Health at the Subscription Price for an aggregate of $8,000. The Subscription Price represented a 25% discount off the volume weighted average price of the Company's common shares on the TSX during the five (5) trading days immediately preceding the filing of the prospectus on July 15, 2009. The rights offering resulted in the reduction of the conversion price of the 2006 Notes to US$16.03 and rendered such notes immediately convertible; resulted in the reduction of the conversion price of the 2009 Notes to $0.185 and the reduction of the exercise price and increase in outstanding number of the warrants issued in connection with the 2007 Notes (refer to (h) for warrants).

(d) Preferred shares:

In connection with the 2009 Notes financing, and as a condition thereto, BELLUS Health and all of the then existing noteholders agreed to amend the terms of the Original Notes. Holders of US$29,085 principal amount of 2006 Notes and US$4,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into preferred shares in the authorized capital of BELLUS Health and received 3,096 preferred shares per US$1 aggregate principal amount of existing convertible notes, resulting in a conversion price of $0.40 per share. A total of 102,431,160 preferred shares were issued to noteholders who elected to receive preferred shares. The preferred shares are convertible into common shares on a one-to-one basis at the option of the holder, subject to adjustment; entitle the holder to 6% cumulative dividend, payable in cash or common shares at the then market price at the option of the Company; and will automatically be converted into common shares in April 2014. In the event of a delisting of the Company's shares on the TSX, the accrued cumulative yield on the preferred shares would be payable in cash.

10. Share capital (continued):

(d) Preferred shares (continued):

In accordance with GAAP, this conversion of the Original Notes into preferred shares was accounted for in two steps: firstly, as a repurchase of the Original Notes by the Company and, secondly, as an issuance of preferred shares from treasury. The Original Notes were initially accounted for as compound financial instruments with both debt and equity components. Accordingly, upon conversion, the difference between the fair value of the preferred shares and the book value of the Original Notes' debt and equity components and related embedded derivatives, was accounted for partially as an extinguishment of the debt component with a gain on extinguishment of debt in the consolidated statement of operations in the amount of $13,000 (net of a $1,201 loss on settlement of the 2007 Original Notes embedded derivative asset), and partially as a capital transaction related to the repurchase of the equity component in the amount of $2,659, which was charged to the deficit. The fair value of preferred shares was determined based on the value of common shares at the date of issuance, as preferred shares are convertible into common shares on a one-to-one basis, and by discounting at a rate of 41.02% the cumulative yield payments due at maturity. The preferred shares issued on conversion possess both liability and equity attributes and therefore were also accounted for as compound financial instruments with both a debt and an equity component; the debt component in the amount of $2,456, net of issue costs of $22 and deferred tax liability of $331, represents the present value of the future yield stream, while the residual amount of the fair value of the preferred shares in the amount of $28,984, net of tax of $331, was allocated to the preferred shares. Related issue costs of $290 have been charged to the deficit. The debt component is classified in Accrued liabilities and Long-term accrued liabilities in the consolidated balance sheet. The accretion of the debt component amounted to $380, net of tax of $430, for the year ended December 31, 2010 (2009 - $639, net of tax of $112).

During the year ended December 31, 2010, 18,620,000 preferred shares were converted into 20,554,365 common shares. Consequently, on conversion, the amounts of $4,569 and $491 were reclassified from preferred shares and long-term accrued liabilities, respectively, to common shares (2009 - 4,600,000 preferred shares were converted into 4,600,000 common shares, for which amounts of $1,190 and $99 were reclassified from preferred shares and long-term accrued liabilities, respectively, to common shares).

10. Share capital (continued):

(e) Stock option plan:

Under its stock option plan, the Company may grant options to purchase common shares to employees, directors and consultants of the Company (the Stock Option Plan). The terms, number of common shares covered by each option, as well as the vesting period are determined by the Board of Directors. In general, options vest over periods of up to five years. The maximum number of shares reserved for issuance is equal to 12.5% of the issued and outstanding common shares. The maximum number of common shares which may be optioned in favor of any single individual shall not exceed 5% of the issued and outstanding common shares of the Company. The option price per share is equal to the weighted average trading price of common shares for the five days preceding the effective date of grant during which the common shares were traded on the TSX. In no event may the term of any option exceed ten years from the date of the grant of the option.

Changes in outstanding options issued under the Stock Option Plan for the years ended December 31, 2010 and 2009 were as follows:

	Number	Weighted average exercise price
Options outstanding, December 31, 2008	4,649,008	$ 5.63
Granted	825,000	0.22
Forfeited	(652,617)	10.13
Expired	(102,050)	3.38
Options outstanding, December 31, 2009	4,719,341	4.11
Granted	6,831,000	0.17
Forfeited	(1,062,680)	0.39
Expired	(5,500)	9.21
Options outstanding, December 31, 2010	10,482,161	$ 1.91

10. Share capital (continued):

(e) Stock option plan (continued):

The following table summarizes information about options outstanding and exercisable at December 31, 2010:

	Options outstanding			Options exercisable	
Exercise price/share	Number	Weighted average exercise price	Weighted average years to expiration	Number	Weighted average exercise price
$ 0.07 - $0.14	4,081,000	$ 0.13	9.5	–	$ –
$ 0.20 - $0.56	2,791,000	0.24	9.2	171,000	0.23
$ 1.50 - $2.07	2,660,600	1.52	7.2	1,574,240	1.51
$ 2.99 - $3.56	105,728	3.11	2.3	100,978	3.09
$ 6.79 - $6.93	123,000	6.86	4.0	98,200	6.84
$ 8.37 - $10.27	106,000	8.95	2.9	106,000	8.95
$13.48 - $15.35	120,500	15.23	5.3	97,900	15.21
$17.40 - $23.35	337,333	19.27	4.7	269,800	19.59
$25.30 - $32.25	157,000	27.68	3.8	157,000	27.68
	10,482,161	$ 1.91	8.2	2,575,118	$ 6.01

(f) Agreement to issue shares:

The agreement with Dr. Francesco Bellini, then Chief Executive Officer, effective December 1, 2004, to issue to him up to 220,000 common shares upon the execution of the agreement and upon achievement of specified performance targets, was approved by regulatory authorities and shareholders in 2005. As at December 31, 2010, stock-based compensation expense in relation to 140,000 of the total 220,000 common shares was previously recorded. The shares will be issued by the Company upon formal notification by Dr. Francesco Bellini. During the years ended December 31, 2010 and 2009, the Company did not record additional stock-based compensation in relation to common shares to be issued to Dr. Francesco Bellini in connection with his execution and achievement of certain specified targets.

(g) Deferred share unit plan:

The Company has various deferred share unit (DSU) plans for employees and members of the Board of Directors created to afford the Company the flexibility to offer DSUs as an alternative to cash compensation.

10. Share capital (continued):

(g) Deferred share unit plan (continued):

The price of DSUs is determined by the five-day volume weighted average trading price of the Company’s common shares at the time the DSUs are issued, as provided for under the respective plans. The DSUs are redeemable only upon the participant’s resignation, termination, retirement or death, in cash, at a value equal to the number of DSUs credited, multiplied by the 5-day market value weighted average price of common shares prior to the date on which a notice of redemption is filed.

For DSUs, compensation cost is measured based on the market price of the Company's common shares from the date of grant through to the settlement date. Any changes in the market value of the Company's common shares through to the settlement date result in a change to the measure of compensation cost for those awards and are recorded in the consolidated statement of operations.

Changes in the number of units for the years ended December 31, 2010 and 2009 were as follows:

Number of units	December 31, 2010	December 31, 2009
Balance, beginning of year	6,293,833	49,755
Units granted	199,574	6,458,654
Units paid	(765,486)	(214,576)
Units forfeited	(228,949)	–
Balance, end of year	5,498,972	6,293,833
Balance, December 31	$ 880	$ 1,133

During the year ended December 31, 2010, the Company granted 199,574 DSUs (2009 – 6,458,654), having a weighted average fair value per unit of $0.15 (2009 - $0.26). The stock-based compensation recorded in the consolidated statements of operations for the years ended December 31, 2010 and 2009 is $(161) and $1,206, respectively. For the year ended December 31, 2010, 765,486 units were redeemed for $92 (2009 - 214,576 units redeemed for $78). At December 31, 2010, the Company had a liability of $880 (2009 - $1,133) with respect to issued DSUs.

10. Share capital (continued):

(h) Warrants

As at December 31, 2010, warrants issued in connection with the 2007 Notes (see note 9 (b)) to purchase an aggregate of 14,560,287 common shares (2009 - 13,589,602) of the Company until May 2, 2012, at a purchase price of US$1.96 per share (2009 - US$2.10), are outstanding. The warrants include anti-dilution provisions in respect of issuances of securities or distributions to shareholders, which result in the adjustment of the number and price of the warrants. The number and price of the warrants were adjusted as a result of the April 2009 financing.

(i) Incentive compensation agreement:

On March 22, 2010, the Board of Directors approved an incentive compensation agreement whereby, subject to the accomplishment by the Company of certain medium to long term performance targets, 8,750,000 common shares are to be issued to certain executives or these executives will receive the cash equivalent in lieu calculated at the then market price, at the option of the Company. This incentive compensation arrangement remains subject to certain ongoing conditions, including TSX requirements. As a result of the workforce reduction (see note 7 (a)), the Company's obligation to potentially issue common shares under the March 22, 2010, incentive compensation agreement has been reduced by 750,000 common shares. During the year ended December 31, 2010, the Company has not recorded any stock-based compensation in relation to these shares because the achievement of the targets is not currently considered probable. The weighted average grant-date fair value of these shares is $0.11 per share.

On May 12 and August 9, 2010, the Board of Directors approved incentive compensation agreements whereby, 4,125,000 and 1,650,000 incentive compensation units were issued to the Board of Directors and employees, respectively. An additional 550,000 incentive compensation units were issued in the fourth quarter of 2010, as a result of a new appointment to the Company's Board of Directors. Each incentive compensation unit is equivalent to the market value of one common share of the Company. Subject to the accomplishment by the Company of certain medium to long term performance targets, each incentive compensation unit will entitle the holder to receive the cash equivalent calculated at the then market price of the Company's common share. During the year ended December 31, 2010, the Company has not recorded any stock-based compensation in relation to these agreements because the achievement of the targets is not currently considered probable. The weighted average grant-date fair value of these units is $0.10 and $0.04 per unit, respectively.

11. Stock-based compensation:

For the year ended December 31, 2010, the Company recorded total stock-based compensation (excluding compensation under the DSU plans) of $1,389 (2009 - $1,440), related to stock options granted under the Stock Option Plan after July 1, 2002.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes pricing model. The weighted average assumptions for the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Weighted average grant-date fair value per share	$ 0.15	$ 0.19
Risk-free interest rate	2.80%	2.86%
Expected volatility	94%	91%
Expected life in years	7	7
Expected dividend yield	nil	nil

Dividend yield was excluded from the calculation, since it is the present policy of the Company to retain all earnings to finance operations and future growth.

12. Commitments and contingencies:

(a) Operating leases and development costs:

Minimum contractual obligations for the next two years and thereafter are as follows:

	Operating leases	Development costs
2011[(1)]	$ 10,622	$ 251
2012 and thereafter	183	–
	$ 10,805	$ 251

(1) Includes the exercise of the Termination Option under the lease in the amount of $6,000 settled with the issuance of common shares in January 2011 (refer to note 21), as well as Deferred rent promissory notes in the amount of $4,244 to be settled in April 2011 (refer to notes 7 (b) (i) and 21).

12. Commitments and contingencies (continued):

(b) License agreements and research collaborations:

On February 1, 2006, the Company entered into an assignment agreement with Parteq Research and Development Innovations (Parteq) (the Assignment Agreement) which terminated an amyloid license agreement. This amyloid license agreement granted the Company an exclusive worldwide license under certain intellectual property (the Amyloid Intellectual Property). Pursuant to the Assignment Agreement, Parteq agreed and assigned the Amyloid Intellectual Property to the Company for consideration, comprising an upfront payment and various deferred payment amounts, which are approximately equal to the payments provided for in the amyloid license agreement. The Assignment Agreement also provides for annual technology payments, deferred milestone payments and deferred graduated payments based on gross revenues to be generated from commercialized products, which approximate the payments included in the amyloid license agreement.

Under the terms of an agreement with the federal Ministry of Industry (Technology Partnerships Canada Program), as amended in 2005, the Company is committed to pay the federal government royalties equal to 7.24% of certain milestone revenue and 0.724% of end-product sales realized from the commercialization of effective orally-administered therapeutics for the treatment of Alzheimer's disease until December 31, 2010. After December 31, 2010, the Company may have to continue to pay royalties until such time as the aggregate amount of royalties paid pursuant to the agreement reaches $20,540.

(c) Consulting and services agreement:

The payments under the consulting and services agreement with Picchio International Inc. (Picchio International), wholly-owned by Dr. Francesco Bellini and his spouse (see note 13 (a)) will be $250 in 2011, plus reimbursement of applicable expenses for services rendered under the agreement.

(d) Guarantees:

As at December 31, 2010, the Company is contingently liable for letters of credit in the amount of $930. New ABCP Notes and cash are pledged under these letters of credit and are presented as restricted cash in the consolidated balance sheet as at December 31, 2010. The balance of the New ABCP Notes is pledged under the credit facilities. The Company has not recorded a liability with respect to the guarantees, as the Company does not expect to make any payments for these items. The Company has determined that the fair value of the non-contingent obligations requiring performance under the guarantees in the event that specified events or conditions occur approximate the cost of obtaining the letters of credit.

13. Related party transactions:

(a) The management services agreement entered into in March 2003, with Picchio International, was amended in June 2009, whereby a portion of the management fee was settled in DSUs ($700 for the year ended December 31, 2009). These DSUs are included in note 10 (g), where the terms of these DSUs are described. The management services agreement with Picchio International expired on December 31, 2009, which corresponded with Dr. Francesco Bellini's retirement as President and Chief Executive Officer. As of January 1, 2010, Dr. Francesco Bellini remains Chairman of the Board of Directors and is also providing ongoing advisory services to the Company under the terms of a new consulting and services agreement between the Company and Picchio International. The agreement has a one-year term and shall renew for successive one-year terms. The Company recorded fees and expenses of $381 for the year ended December 31, 2010 (2009 - $1,817).

In relation to the KIACTA™ asset sale and license agreement, the Company also recorded fees of $261 (US$250) during the second quarter of 2010, payable to Dr. Francesco Bellini under the terms of the consulting and services agreement.

In 2010, the Company entered into a license and supply agreement with FB Health, a company controlled by Dr. Francesco Bellini. See note 5 (b) (i).

In 2004, the Company entered into an agreement to issue shares to Dr. Francesco Bellini, then Chief Executive Officer. See note 10 (f).

These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

14. Income taxes:

(a) Details of the components of income taxes are as follows:

	Year ended December 31, 2010	Year ended December 31, 2009
Loss before income taxes:		
Canadian operations	$ (10,946)	$ 5,914
Foreign operations	(9,167)	(14,704)
	(20,113)	(8,790)
Basic income tax rate	29.9%	30.9%
Computed income tax recovery	(6,014)	(2,716)
Adjustments in income taxes resulting from:		
Non-recognition of losses and other deductions	(366)	5,550
Difference in tax rate of a foreign subsidiary	2,258	2,981
Non-deductible stock option expense	367	812
Permanent differences and other	3,755	(6,627)
	$ –	$ –

14. Income taxes (continued):

(b) Net future tax assets:

The future tax assets and liabilities at December 31, 2010 and 2009 are as follows:

	2010	2009
Future tax assets:		
Patent costs	$ 5,279	$ 5,219
Unclaimed scientific research and experimental development expenditures for tax purposes	27,648	26,233
Deferred gain on sale of property	162	1,978
Accrued liabilities	1,814	2,313
Share issue costs	416	863
Net operating losses	19,331	24,058
Other	2,172	246
	56,822	60,910
Less: valuation allowance	(56,500)	(60,221)
	322	689
Future tax liabilities:		
Equipment	(233)	(612)
Deferred financing fees	(89)	(77)
Notes	–	–
Net future tax assets	$ –	$ –

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income and/or tax planning strategies. Since the Company is a development stage enterprise, the generation of future taxable income is dependent on the successful commercialization of its products and technologies.

(c) The Company has the following unclaimed deductions available to reduce future taxable income in Canada:

	Federal	Quebec
Research expenditure pool (no expiry)	$ 125,220	$ 74,503

14. Income taxes (continued):

(c) (continued):

The Company also has approximately $21,155 in federal research investment tax credits that can be used to reduce future federal taxes payable and which expire as follows:

2020	$ 18
2021	167
2022	230
2023	431
2024	3,682
2025	4,399
2026	3,774
2027	4,031
2028	2,216
2029	1,368
2030	839
	$ 21,155

(d) The Company has non-capital losses carried forward which are available to reduce future years' taxable income. These expire as follows:

	Canadian companies	Foreign subsidiaries [1]
2011	$ –	$ 56,394
2012	1,680	62,248
2013	1,660	76,927
2014	–	108,019
2015	–	78,279
2016	–	26,114
2017	–	5,252
2024	3,786	–
2025	3,410	–
2026	2,012	–
2027	6,887	–
2028	1,437	–
2029	991	–
2030	701	–
	$ 22,564	$ 413,233

[1] In 2010, the Company initiated a corporate reorganization process whereby the Company will unwind its international structure by closing its subsidiaries in Europe and the United States. The corporate reorganization will have an impact on the availability of the Company's tax losses.

15. Basic and diluted loss per share:

The reconciliation between basic and diluted loss per share is as follows:

	Year ended December 31, 2010	Year ended December 31, 2009
Basic loss per share:		
Basic weighted average number of common shares outstanding	211,341,161	140,186,578
Basic net loss per share	$ (0.10)	$ (0.06)
Diluted loss per share:		
Net loss	$ (20,113)	$ (8,790)
Adjustments for dilutive impacts of 2006 and 2007 Original Notes	–	(18,682)
Net loss for calculation of diluted loss per share	$ (20,113)	$ (27,472)
Basic weighted average number of common shares outstanding	211,341,161	140,186,578
Plus dilutive impact of 2006 and 2007 Original Notes	–	847,806
Diluted weighted average number of common shares outstanding	211,341,161	141,034,384
Diluted net loss per share	$ (0.10)	$ (0.19)

As the preferred shares are automatically converted into common shares at maturity, if not voluntarily converted before in accordance with their terms, they embody a right to the residual equity of the Company for which the only condition to issuance is the passage of time and, therefore, are included in the basic weighted average number of common shares outstanding. Also, included in the weighted average number of shares outstanding are 140,000 common shares to be issued to Dr. Francesco Bellini upon formal notification. See note 10 (f).

15. Basic and diluted loss per share (continued):

Excluded from the calculation of the diluted loss per share are the effects of stock compensation plan, 2009 Notes, Amended Notes, Deferred Rent promissory notes, warrants and debt component on preferred shares, as the effect would be anti-dilutive. All outstanding stock compensation plan, 2009 Notes, Amended Notes, Deferred Rent promissory notes, warrants and debt component on preferred shares could potentially be dilutive in the future.

16. Statements of cash flows - supplementary disclosure:

(a) Cash and cash equivalents:

Cash and cash equivalents consist of cash balances with banks and short-term investments:

	2010	2009
Cash balances with banks	$ 4,290	$ 14,017
Short-term investments (yielding interest from 0.11% to 0.18% as at December 31, 2010)	5,967	–
	$ 10,257	$ 14,017

(b) Interest and income taxes:

	Year ended December 31, 2010	Year ended December 31, 2009
Cash paid for:		
Interest	$ 208	$ 210
Income tax	–	–

17. Segment disclosures:

(a) Business segment:

The Company operates in one business segment, the research and development of products for health solutions. The Company's operations are conducted principally in Canada and Europe.

(b) Equipment by geographic area is as follows:

	2010	2009
North America	$ 92	$ 2,554
Europe	–	41
	$ 92	$ 2,595

(c) Significant sources of revenue:

In 2010, 97% of revenue from asset sale, licensing and supply agreements comes from Celtic and AOR (see note 5).

18. Capital disclosures:

The Company's objective in managing capital is to ensure a sufficient liquidity position to market its technologies and product candidates, to finance its research and development activities, general and administrative expenses, working capital and overall capital expenditures.

Since inception, the Company has financed its liquidity needs primarily through public offerings of common shares, private placements, issuance of convertible notes as well as a sale-leaseback transaction. When possible, the Company tries to optimize its liquidity needs by non-dilutive sources, including research tax credits, grants, interest income, as well as with proceeds from the collaboration and research agreements, sale of assets, supply agreements or product licensing agreements.

The Company issued common shares for the payment of interest on convertible notes (refer to note 9 (b)), as well as for the exercise of the Termination option (refer to note 21). The Company expects to settle the Deferred Rent payable on April 7, 2011 with the issuance of common shares from treasury (refer to notes 7 (b) (i) and 21).

The Company defines capital to include total shareholders' deficiency (excluding accumulated other comprehensive income) and notes.

As at December 31, 2010, the Company had convertible and promissory notes in the amount of $24,615, with an aggregate face value of $38,220.

18. Capital disclosures (continued):

The capital management objectives remain the same as for the previous fiscal year.

As at December 31, 2010, cash and cash equivalents amounted to $10,257. The Company requires continued access to capital markets to support its operations, as well as to achieve its strategic plans. Any impediments to the Company's ability to continue to meet the conditions contained in its credit facilities and convertible notes as well as the Company's ability to access capital markets, including the lack of financing capability or an adverse perception in capital markets of the Company's financial condition or prospects, could have a materially adverse effect on the Company. In addition, the Company's access to financing is influenced by the economic and credit market environment. See note 1 (a).

The Company's general policy on dividends is to retain cash to keep funds available to finance the Company's growth.

The Company is not subject to any capital requirements that are externally imposed.

19. Financial instruments:

(a) Financial instruments - carrying values and fair values:

Fair value estimates are made as of a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and may not be determined with precision. A three-tier fair value hierarchy prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

19. Financial instruments (continued):

(a) Financial instruments - carrying values and fair values (continued):

Financial assets and liabilities fair valued on a recurring basis, as at December 31, 2010 and 2009, presented by Level of the fair value hierarchy for which the fair value is determined:

	December 31, 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 10,257	$ 10,257	$ –	$ –
Other restricted cash	281	281	–	–
Investment in New ABCP Notes and restricted cash	7,046	–	–	7,046
Liabilities:				
Derivative-related liability	(353)	–	–	(353)

	December 31, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 14,017	$ 14,017	$ –	$ –
Investment in New ABCP Notes and restricted cash	7,240	–	–	7,240
Other restricted cash	382	382	–	–
Liabilities:				
Derivative-related liability	(372)	–	–	(372)

19. Financial instruments (continued):

(a) Financial instruments - carrying values and fair values (continued):

For the years ended December 31, 2010 and 2009, the reconciliation of the beginning and ending balance of assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) is as follows:

	Investment in New ABCP Notes and restricted cash	Derivative-related liability
Balance as at January 1, 2009	$ 10,855	$ –
Proceeds	(3,156)	–
Issuance of 2009 Notes	–	(438)
Foreign exchange (loss) gain	(717)	22
Total gains included in earnings (reported as change in fair value)	258	44
Balance as at December 31, 2009	7,240	(372)
Proceeds	(761)	–
Foreign exchange loss	(96)	–
Total gains included in earnings (reported as change in fair value)	663	19
Balance as at December 31, 2010	$ 7,046	$ (353)

The amount of total gains included in earnings attributable to the change in unrealized gain related to assets and liabilities still held at reporting date was as follows:

	2010	2009
Investment in New ABCP Notes and restricted cash	$ 663	$ 258
Derivative-related liability	19	44

19. Financial instruments (continued):

(a) Financial instruments - carrying values and fair values (continued):

The Company has determined that the carrying value of its short-term financial assets and liabilities approximates their fair value because of the relatively short periods to maturity of these instruments. The carrying value of the financial liabilities included in long-term liabilities also approximates fair value. The fair value of convertible notes is estimated based on discounting expected future cash flows at the discount rates which represent borrowing rates presently available to the Company for instruments with similar terms and maturity.

The fair values of the Notes were as follows:

		December 31, 2010		December 31, 2009
	Carrying amount	Fair value	Carrying amount	Fair value
Notes	$ 24,615	$ 35,489	$ 17,350	$ 29,654

(b) Credit risk:

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, accounts receivable, restricted cash and investment in New ABCP Notes. The Company invests cash with major North American and European financial institutions. Cash equivalents are comprised of fixed income instruments with a high credit ranking (not less than A-1) as rated by Standard and Poor’s. The Company has investment policies that are designed to provide for the safety and preservation of principal, the Company's liquidity needs and yields that are appropriate.

As at December 31, 2010, the Company’s maximum credit exposure corresponded to the carrying amount of these financial assets.

Refer to note 4 for credit risk related to investment in New ABCP Notes and restricted cash.

19. Financial instruments (continued):

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure, as outlined in note 18. It also manages liquidity risk by continuously monitoring actual and projected cash flows. The Board of Directors reviews, approves and monitors the Company's operating and capital budgets, as well as any material transactions.

Refer to notes 1 (a) and 18 with respect to material uncertainty in regards to the Company's liquidity.

The following are the contractual maturities of financial liabilities as at December 31, 2010:

	Carrying amount	Contractual cash flows	Less than 1 year	2 to 3 years	Greater than 3 years
Credit facilities [1]	$ 9,789	$ 11,224	$ 205	$ 410	$ 10,609
Accounts payable and accrued liabilities	4,121	4,121	4,121	–	–
Financial liabilities included in long-term liabilities [2]	2,559	7,746	–	–	7,746
Notes [3]	24,615	62,691	5,049	1,611	56,031
	$ 41,084	$ 85,782	$ 9,375	$ 2,021	$ 74,386

[1] Assuming interest calculated at the interest rate in effect at the balance sheet date and principal repayment based on available renewal options of the Company.

[2] Assuming payment of accrued cumulative yield on preferred shares in April 2014. The Company has the option to settle the accrued cumulative yield with the issuance of common shares.

[3] Assuming redemption of Amended Notes in January 2014 and redemption of 2009 Notes in April 2014 that includes interest thereon which can be paid in shares.

(d) Foreign currency risk management:

A portion of the Company's expenses are denominated in currencies other than the CDN dollar, primarily in US dollars. This results in financial risk due to fluctuations in the value of the CDN dollar relative to these currencies. As at December 31, 2010, the Company holds a significant portion of cash and cash equivalents in US dollars while the majority of its expenses are denominated in CDN dollars. The Company converts the cash and cash equivalents to CDN dollars as needed while awaiting favourable foreign exchange conditions. The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results.

19. Financial instruments (continued):

(d) Foreign currency risk management (continued):

The following table provides an indication of the Company's significant foreign exchange currency exposures as at December 31, 2010:

(in CDN dollars)			December 31, 2010
	$US	CHF	EURO
Cash and cash equivalents	7,107	58	89
Accounts receivable	38	42	4
Investment New ABCP Notes	2,372	–	–
Accounts payable and accrued liabilities	(366)	(544)	(201)
Credit facilities	(3,621)	–	–
Long-term liabilities	(2,447)	–	(112)
Notes	(7,277)	–	–
	(4,194)	(444)	(220)

The following exchange rates applied during the year ended December 31, 2010:

	Average rate	Reporting date rate
$US per $CDN	0.9710	1.0054
CHF per $CDN	1.0105	0.9394
EURO per $CDN	0.7320	0.7508

Based on the Company's foreign currency exposures noted above, varying the above foreign exchange rates to reflect a ten percent strengthening of the CDN dollar would have decreased the net loss as follows, assuming that all other variables remained constant:

	$US	CHF	EURO
Decrease in net loss	419	44	22

An assumed ten percent weakening of the CDN dollar would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

19. Financial instruments (continued):

(e) Interest rate risk:

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates.

The Company's exposure to interest rate risk is as follows:

Cash and cash equivalents	Short-term fixed interest rate
Investment in New ABCP Notes	Short-term fixed interest rate
Restricted cash	Short-term fixed interest rate
Credit facilities	Short-term variable interest rate
Notes	Fixed interest rate

Based on the value of variable interest-bearing amount during the year ended December 31, 2010, an assumed 1% increase or 1% decrease in interest rates during such period would have had no significant effect on the net loss.

Management believes that the risk that the Company will realize a loss as a result of the decline in the fair value of its cash equivalents is limited because these investments, although available for sale, have short-term maturities and are generally held to maturity.

The capacity of the Company to reinvest the short-term amounts with equivalent returns will be impacted by variations in short-term fixed interest rates available in the market.

Interest income presented in the consolidated statement of operations represents interest income on available-for-sale financial assets.

20. Comparative figures:

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

21. Subsequent event:

On January 14, 2011, the Company exercised the Termination Option (see note 7 (b) (i)) of the lease of its Laval, Quebec premises, as provided in the amended lease agreement with the landlord of such premises. On January 21, 2011, in consideration for the exercise of the Termination Option, BELLUS Health issued 20,656,320 common shares from treasury to the landlord at a price of $0.290468 per share, for an aggregate value of $6,000. In addition, deferred rent in the amount of $4,244 (including 2011 expected Deferred Rent and all accrued interest thereon) will be payable to the landlord on April 7, 2011, the date of termination of the lease, in cash or, at the Company's option, through an issuance of common shares from treasury.

SHAREHOLDER INFORMATION

EXECUTIVE MANAGEMENT

Mr. Roberto Bellini
President and
Chief Executive Officer

—

Dr. Denis Garceau
Senior Vice President,
Drug Development

—

Mr. François Desjardins
Vice President,
Finance

BOARD OF DIRECTORS

Dr. Francesco Bellini
Chairman of the Board
BELLUS Health Inc.

—

Mr. Charles Cavell
Deputy Chairman,
Consultant

—

Mr. Roberto Bellini
President and chief
excutice officer
of BELLUS Health Inc.

—

Mr. Neil Flanzraich
Consultant

—

Ms. Hélène Fortin
Partner
Demers Beaulne, GPCA

—

Mr. Pierre Larochelle
Vice President, Investments
Power Corporation of Canada

—

Mr. Joseph Rus
Executive Vice President,
Alliance Management & New
Market Development Shire
Pharmaceuticals Group

—

Mr. Franklin Berger
Consultant

—

Dr. Martin Tolar
President and
Chief Executive Officer
of NormOxys Inc.

CORPORATE GOVERNANCE

BELLUS Health is committed to sound corporate governance practices, which ensure that its affairs are managed in the best interest of all stakeholders. The Board of Directors undertakes a periodic review to verify that BELLUS Health's governance practices have kept pace with changing regulatory environments in Canada, to which BELLUS Health is subject as a company listed on the TSX. Please refer to the management proxy circular for more information on the overall structure of the Board and its Committees and for details of BELLUS Health's corporate governance practices.

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CORPORATE PROFILE

BELLUS Health is a development-focused health company concentrating on research and development of products that provide innovative health solutions and address critical unmet medical needs. Our pharmaceutical strategy includes the development of investigational product candidates for the treatment of Amyloid A amyloidosis and Alzheimer's disease.