Bellus HEALTH

Bellus 2011

BELLUS HEALTH
ANNUAL REPORT
— 2011

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 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 BELLUS Health Inc. does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, achievement of forecasted burn rate, achievement of forcasted clinical trial milestones, and that actual results may vary once the final and quality-controlled verification of data and analyses has been completed. 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 BELLUS Health Inc's public filings, including the Annual Information Form, for further risk factors that might affect BELLUS Health Inc. and its business.

Dear Shareholders,

The year 2011 was another important step towards delivering on our objective of developing new drugs in areas of great need. Our business is focused around three key pillars: partnerships, products and people. Let me tell you how we have strived forward in these three areas in 2011.

We believe partnerships are a fundamental way to drive value in the biotech industry. They allow us to take less financial risk while still providing significant upside value. Partnerships also bring important external expertise to help fuel the development and growth of our products. We do not however believe in partnering for the sake of partnering. Every partner needs to be as highly motivated as we are to make our products successful. These are our partners:

- Celtic Therapeutics – Celtic Therapeutics is a large global pharmaceutical fund who we are working with to develop KIACTA™, our lead Phase III project for AA amyloidosis. Celtic Therapeutics is a global development fund that brings both significant financial resources and an experienced team to our partnership. The two lead partners of Celtic Therapeutics are Stephen Evans Freke, an entrepreneur who has built and sold multiple biotech companies, and Dr. Peter Corr, the ex-Senior Head of Research and Development at Pfizer.
- VIVIMIND™ Distributors – We currently have 4 distributors for VIVIMIND™ in several important markets including Italy, Canada and the Middle East. We have selected our distributors based on their strong experience in selling natural products and on their strong motivation to succeed with VIVIMIND™.

We are also seeking to be partners to further expand our pipeline. Our business model focuses 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. Therefore, this could mean licensing or acquiring products that we feel we can develop better than anyone else and that will also create value for our shareholders.

Our partnerships have helped us make important progress on the promising products in our pipeline:

- KIACTA™ – Alongside Celtic Therapeutics, we are driving forward on the most important clinical trial that has ever been conducted for AA amyloidosis patients. Our Phase 3 confirmatory trial is not only the most important for AA amyloidosis patients, it is also the largest in this patient population. The study is recruiting approximately 230 patients from approximately 83 sites in 28 countries. The large size of the study is to ensure that we have the best chance of success. The three most important health regulators in the world, the United States FDA, the European EMEA and the Japanese FDA, have opined that they are ready to accept the result from our first Phase II/III study and the results from our on-going Phase III confirmatory study as the basis for marketing approval in their respective jurisdictions. We also believe that the recent decision to expand the Phase III study to Japan will generate significant additional financial return for our shareholders.
- VIVIMIND™ – It has been a busy year working with our current distributors to launch VIVIMIND™ in Italy (January) and Canada (November) as well as expanding the international footprint of VIVIMIND™. Importantly, the cashflow from our VIVIMIND™ partnerships is contributing to reducing our cash burn. In 2011, VIVIMIND™ generated over $300,000 and we expect revenues to significantly increase in 2012.
- NRM8499 – The Phase I results of NRM8499 released in January 2011 proved to be encouraging signs of the potential of this project in Alzheimer's Disease and we continue to seek a potential partnership to take NRM8499 further in its development process.

Last of the three 'P's but equally if not most important, is people. Our employees are the real engine to this Company. While we are a small number, we have assembled a strong team that is dedicated to the Company and its success. I would like to take this opportunity to thank every one of them for the positive attitude they bring to work each and every day. I would also like to thank the Board of Directors for their support and counsel.

Finally, a key element to our success is our shareholders. While our business is to develop drugs, it is also our objective to generate returns for our shareholders. Even though our projects are advancing, we did not generate the shareholder returns that we would have liked in 2011. We appreciate your continued support and patience in 2011. While we have no control over financial markets, we believe in the strong long-term value of the Company and will do the utmost to make sure it is also reflected in the short-term in 2012.

Sincerely,

Roberto Bellini
President and Chief Executive Officer

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MANAGEMENT'S DISCUSSION AND ANALYSIS

BELLUS Health Inc. and its subsidiary (together referred to as BELLUS Health or the Company) is a development-focused health company concentrating on the 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, 2011 and 2010. It should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2011, which are the first annual audited consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). The Company's financial statements were previously prepared in accordance with Canadian Generally Accepted Accounting Principles (Canadian GAAP). For more information regarding the conversion to IFRS, refer to note 23 to the consolidated financial statements for the year ended December 31, 2011. Additional information relating to the Company, including its Annual Report and Annual Information Form, as well as 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.

The consolidated financial statements and MD&A have been reviewed by the Company's Audit Committee and approved by the Board of Directors. This MD&A was prepared by Management with information available as at February 21, 2012.

All currency figures reported in the consolidated financial statements and in this document, including comparative figures, are in CDN dollars, unless otherwise specified.

BUSINESS OVERVIEW

During 2011, BELLUS Health has continued to execute its business plan and increasingly focused its business model on its most promising products, while significantly reducing its burn rate. Progress was made on several fronts, including patient recruitment for the Company's lead drug candidate KIACTA™ and expansion of the distribution footprint in overseas markets for VIVIMIND™. Strategic initiatives have been taken to reduce the Company's operating costs and put in place a leaner organizational structure which is better adapted to the Company's business model.

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	Phase I Clinical trial

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

In addition, the Company is commercializing VIVIMIND™, a natural health product designed to protect memory function, for which marketing and distribution licensing agreements have been signed in several territories.

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.

During 2011, BELLUS Health and its strategic partner Celtic Therapeutics (Celtic) continued the recruitment for the global phase III confirmatory clinical trial for KIACTA™ (eprodisate), which was initiated on December 14, 2010. The trial is designed to confirm the safety and efficacy of KIACTA™ in preventing renal function decline in patients diagnosed with AA amyloidosis. The international, randomized, double-blind, placebo-controlled, event-driven study will involve approximately 230 patients diagnosed with AA amyloidosis recruited from approximately 83 sites in 28 countries worldwide, including those in Japan, as discussed below. Thus far, a total of 72 clinical centers in 26 countries are actively recruiting patients. The phase III confirmatory study is an event-driven trial which will conclude when 120 patients have reached worsening events linked to deterioration of kidney function. There will be periodic data safety monitoring review boards that will independently assess the safety of KIACTA™ throughout the study, of which the first is scheduled in April 2012. No efficacy interim analysis will be performed. Patient recruitment is expected to be completed in the second half of 2013. The phase III confirmatory clinical trial is the last key step before applications for regulatory approval for KIACTA™ can be filed. Further to the expansion of the study to Japan and the extension of the recruitment period, the completion of the study is now expected in second half of 2015.

In January 2012, the Company announced that Japan's Pharmaceutical and Medical Device Agency (PMDA) formally accepted the request to expand the on-going KIACTA™ phase III confirmatory study to Japan. The Japanese part of the study is scheduled to enroll between 10 and 20 patients in up to seven clinical centers in the country. These sites are expected to be activated in the second half of 2012 and will recruit patients for at least one year.

On April 29, 2010, the Company signed an asset sale and license agreement with Celtic, 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 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 tranche of US$5 million on November 4, 2010. Celtic is funding 100% of KIACTA™'s development costs through its Phase III confirmatory 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 entered into between the parties for an initial expected amount of $745,000 (US$745,000) receivable over the life of the agreement, to provide support and assistance to Celtic in connection with their development plan of KIACTA™. In 2011, the Company's expected support and assistance to Celtic have increased, adjusting the expected amount receivable over the life of the agreement to $1,332,000 (US$1,351,000). As at December 31, 2011, the unbilled amount receivable amounts to $638,000, of which $466,000 is presented as current Prepaid expenses and other assets and $172,000 as non-current Prepaid expenses and other assets in the consolidated balance sheet (2010 - $532,000, $172,000 presented as current Prepaid expenses and other assets and $360,000 as non-current Prepaid expenses and other assets).

In 2005, the Company completed an initial Phase II/III clinical trial for KIACTA™ (eprodisate) for the treatment of AA amyloidosis. The results of the 2005 Phase II/III clinical trial found KIACTA™ to be safe and efficacious[1]. Following regulatory discussions with both the US Food and Drug Administration (FDA) and the European Medicines Agency (EMEA) in 2007, it was determined to proceed with a confirmatory phase III study.

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.

<u>NRM8499</u>

The Company is also developing NRM8499, a prodrug of tramiprosate (ALZHEMED™; homotaurine) for the treatment of Alzheimer's disease (AD). In January 2011, BELLUS Health announced the results of the phase I clinical trial for NRM8499, which investigated the safety, tolerability and pharmacokinetic profile of NRM8499 as compared to tramiprosate in a group of 67 young and elderly healthy subjects. The phase I clinical trial data demonstrated that NRM8499 was safe and well tolerated at the intended therapeutic dose.

[1] Dember, L.M. *et al,* NEJM (2007) Vol. 356 : 2349-2360.

Given the early stage of NRM8499, 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.

The Company is currently exploring strategic opportunities with the aim of pursuing the development process of NRM8499. The Company is also exploring opportunities in order to expand its pipeline, including through acquisitions and/or in-licensing.

VIVIMIND™

The Company is commercializing VIVIMIND™, a natural health product designed to protect memory function. VIVIMIND™ is based on homotaurine, a naturally occurring ingredient found in certain seaweed. During 2010 and 2011, the Company signed licensing agreements for the marketing and distribution of VIVIMIND™ in Italy, Canada, Greece, Cyprus and certain countries in the Middle East.

In October 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), which granted FB Health exclusive distribution rights for VIVIMIND™ in Italy., 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.

In December 2010, the Company entered into a share purchase agreement with Advanced Orthomolecular Research Inc (AOR) for the sale of the shares of OVOS Natural Health Inc. (OVOS), the Company's wholly-owned Canadian nutraceutical subsidiary. 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. In addition, the Company and AOR entered into an exclusive license and supply agreement relating to the distribution of VIVIMIND™ in Canada. A Natural Health Product Number (NPN), which granted formal authorization for sale in Canada, was issued by Health Canada for VIVIMIND™ in September 2010.

In April 2011, the Company entered into an exclusive license and distribution agreement with Agahan Ayandeye Pars Inc. (Agahan Group) regarding VIVIMIND™. Pursuant to the agreement, the Company granted the Agahan Group exclusive distribution rights for VIVIMIND™ in Egypt, United Arab Emirates, Pakistan, Iran and certain other Gulf states of strategic importance to the Agahan. The Agahan Group intends to proceed rapidly with obtaining regulatory approval for VIVIMIND™ and expects to launch VIVIMIND™ in the first half of 2012.

In December 2011, the Company entered into an exclusive license and distribution agreement with Integris Pharma Ltd. (Integris) regarding VIVIMIND™, pursuant to which Integris has secured the exclusive right to market and sell VIVIMIND™ in Greece and Cyprus. Integris is a wholly owned subsidiary of Coronis Research S.A., a leading independent Clinical Research Organization in Greece. Integris expects to receive formal regulatory approval from the Greek authorities in the first quarter of 2012 and to launch VIVIMIND™ in Greece and Cyprus in the second quarter of 2012.

BELLUS Health continues to actively pursue partnerships to further expand the commercial footprint of VIVIMIND™in other markets.

Cost reduction initiatives

Since the second quarter of 2010, the Company has been implementing costs reduction initiatives to reduce its fixed-cost base and extend its financial resources. These included the reduction of the Company's head count by more than 75%; the early termination of the lease agreement for the Company's Laval, Quebec premises; and the reorganization of its international structure. As a result, the Company has significantly reduced its required cash outflows.

On January 14, 2011, the Company exercised its right to terminate the lease of its Laval, Quebec premises effective April 7, 2011, as provided in the amended lease agreement dated March 31, 2009 (Amended Lease) with A.R.E. Quebec No. 2, Inc. (A.R.E.), 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 A.R.E. at a price of approximately $0.29 per share, for an aggregate value of $6 million. In addition, on April 7, 2011, the Company issued 34,242,911 common shares at a price of approximately $0.125 per share, as final payment for the deferred rent of approximately $4.3 million payable to the landlord. As provided in the Amended Lease, 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 early termination of the lease resulted 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. The Company has signed a new lease that began on April 8, 2011 at the same premises, for less space.

On March 31, 2011, BELLUS Health completed a corporate reorganization whereby the Company streamlined its international structure by liquidating its subsidiaries in Europe and the United States. The reorganization resulted in the repatriation of BELLUS Health's intellectual property to Canada and the reduction of the Company's operating expenses ("burn rate") by approximately $1.4 million per year.

Other

As at December 31, 2011, 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 14% and 10%, respectively, as of that date, based on the issued and outstanding shares of the Company.

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.

As at December 31, 2011, the Company had cash and cash equivalents in the amount of $5,105,000. Following the cost reduction initiatives implemented by the Company, as discussed above, the Company has significantly reduced its required cash outflows. As at December 31, 2011, based on current estimates, the Company's cash and cash equivalents on hand and expected sources of funds are considered, in management's view, to be sufficient to meet its committed cash obligations and expected level of expenditures into the third quarter of 2013.

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. This material uncertainty may cast significant doubt on the Company's ability to continue as a going concern beyond that period.

Management continues to pursue additional sources of funds including through further arrangements relating to the distribution of VIVIMIND™, its natural health brand, and a potential partnership for NRM8499. 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.

Refer to note 2 (d) of the consolidated financial statements for the year ended December 31, 2011 for further information.

Selected Financial information

(In thousands of dollars, except per share data)

	Years ended December 31		
	2011	2010[(1)]	2009 [(1)]
	$	$	$
Revenues	3,066	2,408	(113)
Expenses:			
Research and development	1,567	9,471	13,749
Research tax credits and grants	(252)	(1,409)	(1,322)
	1,315	8,062	12,427
General and administrative	3,543	8,186	10,995
	4,858	16,248	23,422
Results from operating activities	(1,792)	(13,480)	(23,535)
Finance income	13,254	1,751	20,945
Finance costs	(8,038)	(12,464)	(6,200)
Net finance income (costs)	5,216	(10,713)	(14,745)
Net income (loss)	3,424	(24,553)	(8,790)
Earnings (loss) per share – Basic	0.01	(0.12)	(0.06)
Loss per share – Diluted	(0.01)	(0.12)	(0.19)

	December 31, 2011	December 31, 2010[(1)]	January 1, 2010 [(1)]
Total assets	12,318	21,603	29,351
Total non-current financial liabilities	40,599	49,219	45,579

(1) The Company adopted IFRS in fiscal 2011 with a transition date as at January 1, 2010; financial information as of January 1, 2010 and December 31, 2010 as well as for the year ended December 31, 2010, was restated in accordance with IFRS. However, financial information for the year ended December 31, 2009, which was presented in accordance with Canadian GAAP, was not restated in accordance with IFRS and accordingly, is not comparable with the information for fiscal 2011 and 2010.

RESULTS OF OPERATIONS

Year ended December 31, 2011, compared to the year ended December 31, 2010

Revenues amounted to $3,066,000 for the year ended December 31, 2011, compared to $2,408,000 for the previous year. Revenues mainly consist of revenue from the asset sale and license agreement as well as the service agreement entered into with Celtic in April 2010 for KIACTA™. Revenue, under both Celtic agreements, is recognized on a straight line basis over the development phase conducted by Celtic, estimated to be 49 months to May 31, 2014 as at December 31, 2011, as that time period was considered to be management's best estimate of the pattern of performance of all its obligations under the agreement at that date. Subsequent to year-end, management's estimate of the period of the development phase was revised to 62 months to June 30, 2015. Revenue adjustments in relation to a change in the life of the agreement are recognized prospectively. Revenues also include revenue from distribution agreements in relation to VIVIMIND™, which provide for minimum expected revenue from the supply of the product by BELLUS Health, royalties, as well as sales-based and regulatory milestones. The increase is mainly due to higher revenue generated from the Celtic agreements.

Research and development expenses, before research tax credits and grants, amounted to $1,567,000 for the year ended December 31, 2011, compared to $9,471,000 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, and the NRM8499 phase I clinical trial for the treatment of Alzheimer's disease, which ended in the first quarter of 2011. In addition, since the second quarter of 2010, the Company has been implementing costs reduction initiatives to reduce its burn rate.

Research tax credits and grants amounted to $252,000 for the year ended December 31, 2011, compared to $1,409,000 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 in management's belief for which there is reasonable assurance that the tax credits will be received. The decrease is attributable to lower research and development expenses incurred in Quebec during the current year that are eligible for refundable tax credits.

General and administrative expenses amounted to $3,543,000 for the year ended December 31, 2011, compared to $8,186,000 for the previous year. The decrease is mainly due to a reduction in the workforce and other cost reduction initiatives implemented by the Company to reduce its fixed-cost base and extend its financial resources.

Finance income amounted to $13,254,000 for the year ended December 31, 2011, compared to $1,751,000 for the previous year. The increase is mainly attributable to finance income recorded in 2011 in relation to the decrease in the fair value of the embedded conversion option liability on the 2009 Notes in the amount of $13,105,000, which is mainly attributable to the decrease in the Company's share price. Under IFRS, the conversion option on the 2009 Notes is considered an embedded derivative that is marked to market through income, as it does not meet the criteria to be recorded in equity as it did under previous Canadian GAAP.

Finance costs amounted to $8,038,000 for the year ended December 31, 2011, compared to $12,464,000 for the previous year. The decrease is mainly due to finance costs recorded in 2010 in relation to the increase in the fair value of the embedded conversion option liability on the 2009 Notes in the amount of $5,904,000.

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

Revenues amounted to $2,408,000 for the year ended December 31, 2010, compared to negative $113,000 for the previous year. Revenues for 2010 mainly consist of revenue from the asset sale and license agreement as well as the service agreement entered into with Celtic in 2010 for KIACTA™, recognized on a straight line basis over the development phase conducted by Celtic. Negative revenue for 2009 represents net sales of VIVIMIND™ recorded during the period.

Research and development expenses before research tax credits and grants, amounted to $9,471,000 for the year ended December 31, 2010, compared to $13,749,000 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 2010.

General and administrative expenses amounted to $8,186,000 for the year ended December 31, 2010, compared to $10,995,000 for the previous year. The decrease is mainly due to a reduction of marketing and selling expenses in relation to the commercialization of the Company's natural health product, VIVIMIND™, following the Company's decision in February 2010 to cease its marketing and sales activities in Canada.

Finance income amounted to $1,751,000 for the year ended December 31, 2010, compared to $20,945,000 for the previous year. The decrease is mainly attributable to a gain on extinguishment of debt recorded in 2009 in the amount of $20,530,000, which 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.

Finance costs amounted to $12,464,000 for the year ended December 31, 2010, compared to $6,200,000 for the previous year. The increase is mainly due to finance costs recorded in 2010 in relation to the increase in the fair value of the embedded conversion option liability on the 2009 Notes in the amount of $5,904,000, which is mainly attributable to the increase in the Company's share price. Under IFRS, the conversion option on the 2009 Notes is considered an embedded derivative that is marked to market through income, as it does not meet the criteria to be recorded in equity as it did under previous Canadian GAAP.

Fourth quarter (unaudited)

For the fourth quarter ended December 31, 2011, *net loss* amounted to $2,223,000 ($0.01 per share), compared to a net loss of $12,739,000 ($0.06 per share) for the corresponding quarter the previous year. The decrease in net loss is primarily due to finance costs recorded in 2010 in relation to the increase in the fair value of the embedded conversion option liability on the 2009 Notes in the amount of $9,405,000.

Revenues amounted to $856,000 for the quarter ended December 31, 2011, compared to $1,039,000 for the corresponding quarter the previous year. Revenues mainly consist of revenue from the asset sale and license agreement as well as the service agreement entered into with Celtic in 2010 for KIACTA™. Revenues also include revenue from agreements in relation to VIVIMIND™. The decrease is mainly due to revenue recorded in 2010 in relation to the sale of OVOS shares to AOR.

Research and development expenses, before research tax credits and grants, amounted to $126,000 for quarter ended December 31, 2011, compared to $1,782,000 for the corresponding quarter the previous year. The decrease is mainly attributable to a reduction in expenses incurred in relation to the NRM8499 phase I clinical trial for the treatment of Alzheimer's disease, which ended in the first quarter of 2011. In addition, since the second quarter of 2010, the Company has been implementing costs reduction initiatives to reduce its burn rate.

Research tax credits and grants amounted to $112,000 for the quarter ended December 31, 2011, compared to $182,000 for the corresponding quarter the previous year. The decrease is attributable to lower research and development expenses incurred in Quebec during the current quarter that are eligible for refundable tax credits.

General and administrative expenses amounted to $940,000 for the quarter ended December 31, 2011, compared to $1,191,000 for the corresponding quarter the previous year. The decrease is mainly due to a reduction in the workforce and other cost reduction initiatives implemented by the Company to reduce its fixed-cost base and extend its financial resources.

Finance income amounted to $224,000 for the quarter ended December 31, 2011, compared to $273,000 for the corresponding quarter the previous year.

Finance costs amounted to $2,349,000 for the quarter ended December 31, 2011, compared to $11,260,000 for the corresponding quarter the previous year. The decrease is mainly due to finance costs recorded in 2010 in relation to the increase in the fair value of the embedded conversion option liability on the 2009 Notes in the amount of $9,405,000, which is mainly attributable to the increase in the Company's share price.

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

Quarters	Revenues	Net income (loss)	Basic earnings (loss) per share	Diluted loss per share
	$	$	$	$
Year ended December 31, 2011				
Fourth	856	(2,223)	(0.01)	(0.01)
Third	745	245	Nil	Nil
Second	719	2,103	0.01	Nil
First	746	3,299	0.01	Nil
Year ended December 31, 2010				
Fourth	1,039	(12,739)	(0.06)	(0.06)
Third	764	(4,378)	(0.02)	(0.02)
Second	536	(3,667)	(0.02)	(0.02)
First	69	(3,769)	(0.02)	(0.02)

The following explains the variation of the net income (loss) of a quarter compared to the corresponding quarter of the previous year. The decrease in net loss for the quarter ended December 31, 2011, is primarily due to finance costs recorded in the fourth quarter of 2010 in relation to the increase in the fair value of the embedded conversion option liability on the 2009 Notes. The increase in net income for the quarters ended September 30, June 30 and March 31, 2011, is primarily due to finance income recorded during these quarters in relation to the decrease in the fair value of the embedded conversion option liability on the 2009 Notes, as well as a decrease in research and development expenses and general and administrative expenses.

Related party transactions

Dr. Francesco Bellini is the Chairman of the Board of Directors and provides ongoing advisory services to the Company under the terms of a consulting and services agreement between the Company and Picchio International Inc (Picchio International). Picchio International is wholly-owned by Dr. Francesco Bellini and his spouse.

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, 2011 ($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) in 2010, paid to Dr. Francesco Bellini under the terms of the consulting and services agreement.

In October 2010, the Company entered into a license and supply agreement with FB Health Inc., a company controlled by Dr. Francesco Bellini. The Company recorded revenues of $88,000 under this agreement for the year ended December 31, 2011 ($63,000 for the year ended December 31, 2010).

FINANCIAL CONDITION

Liquidity and capital resources

As at December 31, 2011, the Company had available cash and cash equivalents of $5,105,000, compared to $10,257,000 at December 31, 2010.

For the year ended December 30, 2011, net decrease in cash and cash equivalents amounted to $5,152,000 compared to $3,760,000 for the corresponding period the previous year. The net decrease in 2010 is net of proceeds of $10.2 million received in relation to the KIACTA™ asset sale and license agreement entered into with Celtic in 2010. Excluding this cash inflow, net decrease in cash used compared to last year is attributable to cost reduction initiatives implemented by the Company, as discussed previously.

Refer to Financial position and going concern, Financial condition – Contractual obligations, and Financial risk management – Liquidity risk sections for further details on liquidity and capital resources of the Company.

Financing activities

As of December 31, 2011, the Company had three outstanding series of convertible notes.

- 2009 Notes, having a notional value of $21,115,000 (excluding accrued interest):

On April 16 and June 3, 2009, the Company issued convertible notes to Vitus and VSVI (the Investors) having a notional value of $21,115,000 (2009 Notes).

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 on the 2009 Notes accrues at the rate of 15% per year, compounded annually. The 2009 Notes mature in April 2014. At maturity, the notional value and the related accrued interest on the notes are payable in cash or common shares of the Company, at the option of the holder.

The initial conversion price of the 2009 Notes at maturity was $0.20 per share (the Financing Conversion Price). The 2009 Notes include customary anti-dilution provisions with respect to the issuances of additional securities or distributions to shareholders whereby the initial Financing Conversion Price gets adjusted upon the occurrence of the events. In addition, should the Company issue additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, a “full ratchet” anti-dilution protection requires a downward adjustment to such Financing Conversion Price, subject to certain exceptions. The terms of the 2009 Notes have been amended in November 2011 to exclude from the “full ratchet” anti-dilution protection certain equity or equity-linked security issuances.

As of December 31, 2011, taking into consideration the shares issued by the Company since 2009, the Financing Conversion Price is $0.07 (Adjusted Financing Conversion Price) ($0.07 as at December 31, 2010 and $0.185 as at January 1, 2010). 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 the Company. 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 the Company.

- Amended 2006 Notes, having a notional value of US$13,000,000 and Amended 2007 Notes having a notional value of US$500,000:

In connection with and as a condition to the 2009 Notes financing discussed above, the Company and all of the existing noteholders agreed in April 2009, in order to reduce cash interest payments, to amend the terms of the then outstanding 2006 Notes and 2007 Notes (2006 and 2007 Original Notes), to either make them convertible into a new series of preferred shares of the Company and to have these notes converted into such preferred shares immediately, or to otherwise amend the existing notes which remained outstanding.

Holders of US$29,085,000 principal amount of 2006 Original Notes and US$4,000,000 principal amount of 2007 Original Notes agreed to amend the terms of their notes to make them convertible into the preferred shares in the authorized capital of BELLUS Health. A total of 102,431,160 preferred shares were issued to noteholders 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 holders 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. As at December 31, 2011, the Company had 78,948,000 preferred shares outstanding which are convertible at anytime into common shares on a one for one basis.

Holders of 2006 and 2007 Original Notes that chose not to convert their amended notes immediately into preferred shares retained original notes, amended as set out below. The remaining holders of US$13,000,000 principal amount of 2006 Original Notes and the one remaining holder of 2007 Original 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 provide for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of the Company at the then market price of the common shares, and 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 holders to have the Company redeem the Original Notes in November 2011 with a right to have the Company first redeem the Amended Notes in January 2014 at the then notional value of the Amended Notes. The amendments to the notes also include the removal of certain negative covenants

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 2006 and 2007 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.

In addition, as a condition precedent to the 2009 Notes 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, 2011, BELLUS Health issued 13,519,810 common shares (2010 – 7,517,258 common shares) in payment of interest on the outstanding 2006 and 2007 Amended Notes. During the year ended December 31, 2011, the Company issued 318,281 common shares (2010 - 20,554,365 common shares) upon conversion of preferred shares.

During the year ended December 31, 2011, nil options to purchase common shares were granted (2010 – 6,831,000 options), 5,000 options to purchase common shares were exercised (2010 - nil), 1,210,945 options to purchase common shares were forfeited (2010 - 1,062,680 options) and 55,958 options to purchase common shares expired (2010 - 5,500 options).

Investing activities

In 2007, the Canadian third party asset-backed commercial paper (ABCP) market was hit by a liquidity disruption. A Pan-Canadian Investors Committee (the Committee) was established to oversee the restructuring of these instruments. In 2009, the Committee announced that the ABCP restructuring plan had been implemented pursuant to which holders of ABCP had their short-term commercial paper exchanged for longer-term notes. As of that date, the Company held a portfolio of ABCP issued by several trusts with overall notional value of $7,589,000 and US$5,977,000. The Company then received new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP, pursuant to the terms of the restructuring plan.

As at December 31, 2011, the Company held New ABCP Notes having notional value of $6,023,000 and US$3,358,000, consisting of $2,299,000 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, US$3,281,000 of MAV3 IA Tracking Notes, as well as US$77,000 and $275,000 of MAV3 TA Tracking Notes During the year ended December 31, 2011, the Company received partial payments for capital of $425,000, and for interest of $68,000 (2010 - $738,000 and $23,000, respectively).

In 2009, in connection with the restructuring of the ABCP market, the Company entered into secured revolving credit facilities with the chartered bank that sold the ABCP to the Company. These facilities mature in April 2013, with options to renew on an annual basis until April 2016. As of December 31, 2011, these credit facilities have combined maximum aggregate available amounts of approximately $8,797,000, which was fully drawn ($9,789,000 as of December 31, 2010, and $10,856,000 as of January 1, 2010, of which $92,000 was not drawn), bear interest at prime rate minus 1% per annum (weighted average effective interest rate was 2.25% in 2011 (2010 - 2.02%)), and are secured by an aggregate $18,400,000 hypothecs 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 and availability of these credit facilities decrease 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. During the second quarter of 2011, the Company exercised its put option on one of the credit facilities, which reduced the aggregate credit facilities by $638,000, and the notional value of the New ABCP Notes by $850,000.

The investments in New ABCP Notes are measured at fair value in the consolidated financial statements. As at December 31, 2011, the Company estimated the fair value of the New ABCP Notes at approximately $6,006,000 of which $412,000 is presented as non-current Restricted cash in the consolidated balance sheet ($7,046,000 as at December 31, 2010, of which $379,000 is presented as non-current Restricted cash, and $7,240,000 as at January 1, 2010, of which $322,000 is presented as non-current Restricted cash), 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 determination, the Company recorded a decrease in fair value of $17,000 for the year ended December 31, 2011 (2010 - increase of $663,000), which is presented in Finance income (costs) in the consolidated statement of comprehensive income (loss).

The Company estimated the fair value of the New ABCP Notes by discounting the expected cash flows at yields comparable to prevailing market yields and credit spreads available for securities with similar characteristics to the New ABCP. The Company reviewed its assumptions to factor in new information available, as well as changes in market conditions. As at December 31, 2011, the Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.78% (weighted average rate of 0.71%), 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 five years and using discount rates ranging from 8.4% to 30% (weighted average rate of 15.1%).

In determining the fair value of certain series of New ABCP Notes, the Company took into account the put option feature included in the credit facilities. The fair value of the put options and change in fair value thereof are presented with New ABCP Notes and related change in fair value in the consolidated balance sheet and statement of comprehensive income (loss).The Company did not take into consideration market trades entered into on certain series of New ABCP Notes, as they are not considered to be sufficient to represent an active market. 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, 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 fair value each period, such adjustments would directly impact earnings.

Other

As a condition precedent to the 2009 Notes 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. See Business overview – Cost reduction initiatives section for details.

In 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 agreement 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 this incentive compensation agreement has been reduced by 1,312,500 common shares. During the years ended December 31, 2010 and 2011, 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.

In 2010, the Board of Directors approved incentive compensation agreements whereby, 4,675,000 and 1,650,000 incentive compensation units were issued to the Board of Directors and employees, respectively. 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. As a result of employee departures, the Company's obligation to potentially issue units under the incentive compensation agreement to employees has been reduced by 475,000 units. During the years ended December 31, 2010 and 2011, the Company has not recorded any stock-based compensation in relation to these units because the achievement of the targets is not currently considered probable.

As at February 21, 2012, the Company had 207,253,050 common shares outstanding, 220,000 common shares issuable to Dr. Francesco Bellini upon the achievement of specified performance targets, 9,210,258 options granted under the stock option plan, 78,948,000 preferred shares outstanding which are convertible into common shares on a one for one basis, 17,191,674 warrants outstanding as well as convertible notes outstanding in the amount of US$13,500,000 and $21,115,000.

As at December 31, 2011, assuming that the 2006 and 2007 Amended Notes and preferred shares are settled in common shares, including interest, at the December 31, 2011 closing price of $0.045, and the 2009 Notes, including interest, are settled in common shares at the Adjusted Financing Conversion Price of $0.07, approximately 1.2 billion additional common shares would be issued, representing a potential dilution factor of 585%, based on 207,253,050 common shares issued and outstanding as at December 31, 2011.

Contractual Obligations

As at December 31, 2011, BELLUS Health's minimum future contractual obligations are principally for payments in relation to the convertible notes, credit facilities and yield on preferred shares, as well as trade and other payables, operating leases and consulting fees for Picchio International. 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	280	202	78	Nil	Nil
Consulting fees	250	250	Nil	Nil	Nil
Credit facilities(1)	9,670	202	403	9,065	Nil
Convertible notes (2)	34,845	Nil	34,845	Nil	Nil
Interest payments on convertible notes (2)	23,037	824	22,213	Nil	Nil
Yield on preferred shares (3)	7,780	Nil	7,780	Nil	Nil
Trade and other payables	1,218	1,218	Nil	Nil	Nil

(1) 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.

(2) Assumes redemption of Amended Notes in January 2014 and redemption of 2009 Notes in April 2014. Refer to Liquidity and Capital Resources – Financing Activities section and to note 12 to the consolidated financial statements for the year ended December 31, 2011 for terms and conditions.

(3) 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.

The Company has a letter of credit issued in connection with a lease agreement in the amount of $465,000. New ABCP Notes and cash are pledged under the letter of credit and are presented as restricted cash on the consolidated balance sheet as at December 31, 2011. 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 16 of the consolidated financial statements for the year ended December 31, 2011.

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, 2011, is the carrying value of its financial assets, including the investments in New ABCP Notes. Credit risk relating to cash and cash equivalents is managed by investing cash resources with major North American 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 investments 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 years such as reducing its workforce, early terminating its lease agreement and the reorganization of its international structure, the Company has significantly reduced its required cash outflows. As at December 31, 2011, the Company's cash and cash equivalents on hand and expected sources of funds are considered, in management's view, to be sufficient to meet its committed cash obligations and expected level of expenditures into the third quarter of 2013. 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. This material uncertainty may cast significant doubt on the Company's ability to continue as a going concern in foreseeable future.

As at December 31, 2011, included in current liabilities are non-cash liabilities such as deferred revenue and 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, the Company is expected to have the ability to meet obligations as they become due in 2012.

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. Should the chartered bank not agree to renew the credit facilities, the Company would have a cash exposure for the difference between the outstanding amount of the credit facilities and the proceeds from the sale of the New ABCP Notes or exercise of put option features of these credit facilities.

The Company manages liquidity risk through the management of its capital structure, as outlined in note 21 to the consolidated financial statements for the year ended December 31, 2011 (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.

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. 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. Note 22 (d) to the consolidated financial statements for the year ended December 31, 2011 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 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

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, 2011.

In connection with the amendment of the December 31, 2010 financial statements, the Chief Executive Officer and Chief Financial Officer had 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. During 2011, management has implemented additional controls and procedures to remediate the material weakness. See below for details.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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, 2011, 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, 2011. 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 had determined that a material weakness existed at December 31, 2010 and as a result, internal control over financial reporting was 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.

Changes in Internal Controls Over Financial Reporting

In accordance with the Canadian Securities Administrators' Multilateral Instrument 52-109, the Company has filed certificates signed by the Chief Executive Officer and the Chief Financial Officer, that among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting.

In relation to the material weakness described in the Company's 2010 annual MD&A, management has implemented additional controls and procedures to remediate the material weakness.

The material weakness was in relation 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 internal technical know-how 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 has increased the consulting services from legal and accounting specialists to aid in the accounting and disclosure in relation to complex transactions. The Company has also enhanced its quarterly review process in relation to its ICFR.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements in conformity with IFRS requires management to adopt accounting policies and to make certain judgments, estimates and assumptions that the Company believes are reasonable based upon the information available at the time these decisions are made. These accounting policies, judgments, 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 2 (d), 3 (f), 6, 10, 12 and 13 (e) and (h) to the consolidated financial statements for judgments and estimates used in the assessment of the entity's ability to continue as a going concern, in the assessment of the amount of research tax credits to be received, and in the valuation of the investments in New ABCP Notes, recognition of revenue, the convertible notes, and stock-based compensation, respectively. The Company's significant accounting policies are described in note 3 to the consolidated financial statements for the year ended December 31, 2011. 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 normal 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 investments in New ABCP Notes, would be reduced to liquidation value.

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. Overhead expenses comprise general and administrative support provided to the research and development programs and involve costs associated with support activities. 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 expenditures undertaken with the prospect of gaining new scientific or technical knowledge are expensed as incurred. Development expenditures are deferred when they meet the criteria for capitalization in accordance with IFRS, and the future benefits could be regarded as being reasonably certain. The criteria to be fulfilled in order to capitalize development costs are if such costs can be measured reliably, if the product or process is technically and commercially feasible, if future economic benefits are probable and if the Company intends to and has sufficient resources to complete the development and to use or sell the asset. As at December 31, 2011 and 2010, and January 1, 2010, no development costs were deferred.

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 government review which could result in adjustment to earnings.

New ABCP Notes: The Company estimates the fair value of the New ABCP Notes by discounting the expected cash flows at yields comparable to prevailing market yields and credit spreads available for securities with similar characteristics to the New ABCP Notes, using assumptions to factor in new information available, as well as changes in market conditions. 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, 2011, 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.

Revenue recognition: Revenue from the Company's different agreements is assessed in order to determine whether they contain separately identifiable components. When separation is required, the consideration received or receivable is allocated amongst the separate components based on the relative fair values of each component. When 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 components. Otherwise, the applicable revenue recognition criteria are applied to the combined components as a whole. 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 separately identifiable component 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 in 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 it is probable that the economic benefits associated with the transaction will flow to the Company;

(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 it is probable that the economic benefits associated with the transaction will flow to the Company;

(iii) distribution fees are recognized when the service has been performed, the amount can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company; and

(iv) revenues from the sale or supply of products are recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the products, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the products sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Amounts received or billed in advance of recognition are presented as deferred revenue. Amounts receivable in advance of progress billing are presented as other assets.

Convertible Notes: The conversion options on the convertible notes contain various features which are considered multiple embedded derivatives under IAS 32, *Financial Statements: Presentation*, and are treated as a single embedded derivative. The Company used an European Binomial option pricing model for the 2009 Notes and a Binomial option pricing model for the 2006 and 2007 Amended Notes to determine the fair value of the embedded conversion option, which is then marked to market through the statement of comprehensive income (loss) at each reporting date. The difference between the value of the embedded conversion option and the notional value of the convertible notes was recognized as debt upon initial recognition and is subsequently measured at amortized cost.

The models used in the valuation of the embedded conversion options on the convertible notes contain certain subjective assumptions, changes to which could cause a significant variation in the estimated fair value of the embedded conversion options.

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 at the date of grant and is expensed over the award's vesting period with a corresponding increase to equity. The fair value of each option granted is estimated on the date of grant using the Black-Scholes pricing model, which requires certain assumptions, including the future stock price volatility and expected time to exercise. Expected volatility is estimated by considering historic average share price volatility. For stock options with graded vesting, the fair value of each tranche is recognized over its respective vesting period. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and performance vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that meet the related service conditions at the vesting date. For non-employees, the fair value of the options is remeasured and recognized over the service period.

Changes to any 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.

CHANGES IN ACCOUNTING POLICIES

Future accounting policies

The following accounting standards were recently issued by the International Accounting Standards Board (IASB):

(a) Financial Instruments: IFRS 9, Financial Instruments, was issued in November 2009. It addresses classification and measurement of financial liabilities and replaces the multiple category and measurement models in IAS 39, Financial Instruments: Recognition and Measurement, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet assessed the impact of IFRS 9 or determined whether it will adopt the standard early.

(b) Consolidation: IFRS 10, Consolidated Financial Statements, was issued in May 2011. IFRS 10 replaces the guidance in IAS 27, Consolidated and Separate Financial Statements and the interpretation of Standing Interpretations Committee (SIC) 12, Consolidation – Special Purpose Entities (SPE). IAS 27 (2008) survives as IAS 27 (2011), Separate Financial Statements, only to carry forward the existing accounting requirements for separate financial statements. IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are SPE in the scope of SIC 12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008). This standard is required to be applied for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company does not expect IFRS 10 to have a material impact on the consolidated financial statements.

(c) Fair value measurement: IFRS 13, Fair Value Measurement, was issued in May 2011. IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRS. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. This standard is required to be applied prospectively for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of IFRS 13 or determined whether it will adopt the standard early.

(d) Employee benefits: In June 2011, the IASB published an amended version of IAS 19, Employee Benefits. The amendment impacts termination benefits, which would now be recognized at the earlier of when the entity recognizes costs for a restructuring within the scope of IAS 37, Provisions, and when the entity can no longer withdraw the offer of the termination benefits. This amendment is required to be applied for annual periods beginning on or after January 1, 2013, with early adoption permitted. The amendment is generally applied retrospectively with certain exceptions. The Company does not expect the amendment to IAS 19 to 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 does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, achievement of the forecasted burn rate, achievement of forecasted clinical trial milestones, 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 International Financial Reporting Standards 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 audits 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
February 21, 2012

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of BELLUS Health Inc.

We have audited the accompanying consolidated financial statements of BELLUS Health Inc., which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of comprehensive income (loss), changes in shareholders' deficiency and cash flows for the years ended December 31, 2011 and December 31, 2010, 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 International Financial Reporting Standards, 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.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of BELLUS Health Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw attention to note 2 (d) in the consolidated financial statements which indicates that BELLUS Health Inc. has incurred significant operating losses and negative cash flows from operations since inception and has an accumulated deficit of $451,681,000 as at December 31, 2011. These conditions, along with other matters as set forth in note 2 (d), indicate the existence of a material uncertainty that may cast significant doubt about BELLUS Health Inc.'s ability to continue as a going concern.

KPMG LLP*

Chartered Accountants

February 21, 2012

Montreal, Canada

*CA Auditor permit no 19544

BELLUS HEALTH INC.

Consolidated Balance Sheets

December 31, 2011 and 2010, and January 1, 2010
(in thousands of CDN dollars)

	December 31, 2011	December 31, 2010	January 1, 2010
Assets			
Current assets:			
Cash and cash equivalents (note 5)	$ 5,105	$ 10,257	$ 14,017
Restricted cash	–	281	–
Trade and other receivables	128	156	378
Assets held for sale (note 7)	–	574	–
Research tax credits receivable	–	1,953	3,618
Prepaid expenses and other assets	810	884	971
Total current assets	6,043	14,105	18,984
Non-current assets:			
Investments in New ABCP Notes (note 6)	5,594	6,667	6,918
Restricted cash (note 6)	463	379	704
Prepaid expenses and other assets	172	360	150
Equipment (note 7)	46	92	2,595
Total non-current assets	6,275	7,498	10,367
Total Assets	$ 12,318	$ 21,603	$ 29,351
Liabilities and Shareholders' Deficiency			
Current liabilities:			
Trade and other payables (note 8)	$ 3,601	$ 9,033	$ 5,616
Provision (note 9)	–	2,999	891
Deferred gain on sale of property	–	1,176	5,409
Deferred revenue (note 10)	2,771	2,703	–
Notes and warrant liability (note 12)	–	3,678	–
Total current liabilities	6,372	19,589	11,916
Non-current liabilities:			
Credit facilities (note 6)	8,797	9,789	10,764
Deferred gain on sale of property	–	–	1,168
Deferred revenue (note 10)	4,169	6,449	–
Long-term liabilities (note 11)	1,409	1,580	4,985
Provision (note 9)	–	–	2,412
Notes and warrant liability (note 12)	30,393	37,850	29,583
Total non-current liabilities	44,768	55,668	48,912
Total liabilities	51,140	75,257	60,828
Shareholders' deficiency:			
Share capital (note 13)	389,597	378,491	376,842
Contributed surplus	23,262	22,960	22,337
Deficit	(451,681)	(455,105)	(430,656)
Total deficiency attributable to equity holders	(38,822)	(53,654)	(31,477)
Basis of preparation (note 2)			
Commitments and contingencies (note 16)			
Total Liabilities and Shareholder's deficiency	$ 12,318	$ 21,603	$ 29,351

See accompanying notes to consolidated financial statements.

On behalf of the Board of Directors by:

(Signed) Hélène Fortin
Director

(Signed) Joseph Rus
Director

BELLUS HEALTH INC.

Consolidated Statements of Comprehensive Income (Loss)

Years ended December 31, 2011 and 2010
(in thousands of CDN dollars, except per share data)

	Year ended December 31, 2011	Year ended December 31, 2010
Revenues (note 10)	$ 3,066	$ 2,408
Expenses:		
Research and development	1,567	9,471
Research tax credits and grants	(252)	(1,409)
	1,315	8,062
General and administrative	3,543	8,186
	4,858	16,248
Results from operating activities	(1,792)	(13,840)
Finance income	13,254	1,751
Finance costs	(8,038)	(12,464)
Net finance income (costs) (note 15)	5,216	(10,713)
Net income (loss) and total comprehensive income (loss) for the year attributable to owners of the Company	$ 3,424	$ (24,553)
Earnings (loss) per share (note 19):		
Basic	$ 0.01	$ (0.12)
Diluted	(0.01)	(0.12)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Changes in Shareholders' Deficiency

Years ended December 31, 2011 and 2010
(in thousands of CDN dollars)

	Share capital	Contributed surplus	Deficit	Total attributable to equity holders of the Company
	(note 13 (b))			
Balance, December 31, 2010	$ 378,491	$ 22,960	$ (455,105)	$ (53,654)
Net income and total comprehensive income for the period	–	–	3,424	3,424
Transactions with owners, recorded directly in shareholders' deficiency:				
Stock-based compensation (note 13 (e))	–	302	–	302
Issued on exercise of Termination Option (note 13 (c))	6,000	–	–	6,000
Issued in connection with payment of Deferred Rent (note 13 (c))	4,290	–	–	4,290
Issued on payment of interest on convertible notes (note 12 (b))	808	–	–	808
Conversion of preferred shares into common shares (note 13 (d))	7	–	–	7
Exercise of stock options for cash (note 13 (e))	1	–	–	1
Balance, December 31, 2011	$ 389,597	$ 23,262	$ (451,681)	$ (38,822)

	Share capital	Contributed surplus	Deficit	Total attributable to equity holders of the Company
	(note 13 (b))			
Balance, January 1, 2010	$ 376,842	$ 22,337	$ (430,656)	$ (31,477)
Net loss and total comprehensive loss for the period	–	–	(24,553)	(24,553)
Transactions with owners, recorded directly in shareholders' deficiency:				
Stock-based compensation (note 13 (e))	–	623	–	623
Issued on payment of interest on convertible notes (note 12 (b))	827	–	–	827
Conversion of preferred shares into common shares (note 13 (d))	491	–	–	491
Deferred tax related to items recognized in equity (note 23 (e))	331	–	104	435
Balance, December 31, 2010	$ 378,491	$ 22,960	$ (455,105)	$ (53,654)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2011 and 2010
(in thousands of CDN dollars)

	Year ended December 31, 2011	Year ended December 31, 2010
Cash flows from operating activities:		
Net income (loss) for the period	$ 3,424	$ (24,553)
Adjustments for:		
Depreciation and equipment write-off	46	1,466
Unrealized foreign exchange loss (gain)	210	(520)
Stock-based compensation	(292)	462
Accretion expense	7,433	6,033
Net expense for vacant space	–	373
Change in fair value of warrant liability	(41)	(49)
Change in fair value of embedded conversion option on 2009 Notes	(13,105)	5,904
Change in fair value of New ABCP Notes	17	(663)
Interest income	(108)	(152)
Interest and bank charges	340	527
Amortization of deferred rent liabilities	279	944
Amortization of gain on sale of property	(1,176)	(5,024)
Deferral of lease payments by issuance of promissory notes	513	1,897
Settlement of deferred shares units	(17)	(92)
Changes in operating assets and liabilities:		
Trade and other receivables	28	249
Research tax credits receivable	1,953	1,665
Prepaid expenses and other assets	262	(123)
Trade and other payables, provision and long-term liabilities	(3,405)	(1,645)
Deferred revenue	(2,212)	9,152
	(5,851)	(4,149)
Cash flows from financing activities:		
Credit facilities	(425)	(781)
Interest and bank charges paid	(241)	(277)
Proceeds from issue of shares	1	–
	(665)	(1,058)
Cash flows from investing activities:		
Restricted cash	230	100
Proceeds from New ABCP Notes	493	761
Interest received	40	125
Proceeds from assets held for sale	574	463
	1,337	1,449
Net decrease in cash and cash equivalents	(5,179)	(3,758)
Cash and cash equivalents, beginning of period	10,257	14,017
Effect of foreign exchange on cash and cash equivalents	27	(2)
Cash and cash equivalents, end of period	$ 5,105	$ 10,257

See accompanying notes to consolidated financial statements.

1. Reporting entity:

BELLUS Health Inc. is a company domiciled in Canada. The address of the Company's registered office is 275 Armand-Frappier Blvd., Laval, Quebec, H7V 4A7. The consolidated financial statements as at and for the year ended December 31, 2011 include the accounts of BELLUS Health Inc. and its subsidiary (together referred to as BELLUS Health or the Company). The Company's shares trade on the Toronto Stock Exchange under the symbol BLU. BELLUS Health is a development-focused health company concentrating on the 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 10.

In addition, the Company is commercializing VIVIMIND™, a natural health product designed to protect memory function, for which marketing and distribution licensing agreements have been signed in several territories.

2. Basis of preparation:

(a) Statement of compliance:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). These are the Company's first consolidated financial statements prepared in accordance with IFRS and IFRS 1, *First-time Adoption of International Financial Reporting Standards,* has been applied.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance, and cash flows of the Company is provided in note 23. This note includes reconciliations of total comprehensive income (loss) for the comparative period and equity at the date of transition and for the comparative period to those amounts reported under Canadian GAAP.

These consolidated financial statements for the year ended December 31, 2011, were approved by the Board of Directors on February 21, 2012.

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the consolidated balance sheet:

(i) derivative financial instruments and embedded derivatives are measured at fair value;

(ii) financial assets designated at fair value through profit and loss are measured at fair value;

(iii) liabilities for cash-settled share-based payment arrangements are measured at fair value; and

(iv) assets held for sale are measured at fair value less costs to sell.

(c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

2. Basis of preparation (continued):

(d) 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 Company has incurred significant operating losses and negative cash flows from operations since inception and has an accumulated deficit of $451,681 as at December 31, 2011.

As at December 31, 2011, the Company had cash and cash equivalents in the amount of $5,105. As a result of measures implemented by the Company such as reducing its workforce, amending and early terminating its lease agreement, restructuring its existing debt and streamlining its international structure, the Company has significantly reduced its required cash outflows. As at December 31, 2011, the Company's cash and cash equivalents on hand and expected sources of funds are considered, 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. This material uncertainty may cast significant doubt on 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, and a potential partnership for NRM8499. 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 may 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.

2. Basis of preparation (continued):

(d) Going concern (continued):

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 normal 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, accretion on convertible notes would be accelerated, and all assets, including the investments in New ABCP Notes (defined in note 6), would be reduced to liquidation value.

(e) Use of estimates and judgments:

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. 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 may differ from these estimates.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements relate to the assessment of the Company's ability to continue as a going concern (note 2 (d)) and to the determination of the separate components in accounting for revenue recognition (note 3 (d)).

Information about assumptions and estimation uncertainties with a significant risk of resulting in material adjustments is included within the following notes and is described below:

(i) estimating the timing of regulatory approvals and the pattern of performance for revenue recognition purposes (note 10);

(ii) estimating the fair value of investments in New ABCP Notes (note 6);

(iii) estimating the fair value of the components of the convertible notes (note 12);

(iv) assessing the acceptance by the government agencies of investment tax credit claims made by the Company and the reasonable assurance that the research tax credits will be received (note 3 (f)); and

2. Basis of preparation (continued):

(e) Use of estimates and judgments (continued):

(v) estimating the fair value of the stock-based compensation (note 13 (e) and (h)).

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which they are made and in future periods affected.

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and in preparing the opening IFRS balance sheet at January 1, 2010 for the purposes of the transition to IFRS.

(a) Principles of consolidation:

The consolidated financial statements include the accounts of BELLUS Health Inc. and its subsidiary. 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 measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

Depreciation is based on the cost of an asset less its residual value, and is recognized in income at the following annual rates:

Asset	Basis	Rate/period
Research and office equipment	Declining balance	20%
Computer equipment	Declining balance	30%

3. Significant accounting policies (continued):

(c) Equipment (continued):

Assets held for sale:

Assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Upon such classification, the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognized in income. Gains are not recognized in excess of any cumulative impairment loss.

(d) Revenue recognition:

Revenue from the Company's different agreements is assessed in order to determine whether they contain separately identifiable components. When separation is required, the consideration received or receivable is allocated amongst the separate components based on the relative fair values of each component. When 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 components. Otherwise, the applicable revenue recognition criteria are applied to the combined components as a whole. 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 separately identifiable component 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 in 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 it is probable that the economic benefits associated with the transaction will flow to the Company;

(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 it is probable that the economic benefits associated with the transaction will flow to the Company;

(iii) distribution fees are recognized when the service has been performed, the amount can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company; and

3. Significant accounting policies (continued):

(d) Revenue recognition (continued):

(iv) revenues from the sale or supply of products are recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the products, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the products sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Amounts received or billed in advance of recognition are presented as deferred revenue. Amounts receivable in advance of progress billing are presented as other assets.

Interest income is recognized using the effective interest method.

(e) Research and development:

Research expenditures undertaken with the prospect of gaining new scientific or technical knowledge are expensed as incurred. Development expenditures are deferred when they meet the criteria for capitalization in accordance with IFRS, and the future benefits could be regarded as being reasonably certain. The criteria to be fulfilled in order to capitalize development costs are if such costs can be measured reliably, if the product or process is technically and commercially feasible, if future economic benefits are probable and if the Company intends to and has sufficient resources to complete the development and to use or sell the asset. As at December 31, 2011 and 2010, and January 1, 2010, no development costs were deferred.

(f) 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, as applicable. 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 that the tax credits will be received. Research tax credits claimed for the current and prior years are subject to government review which could result in adjustments to income.

3. Significant accounting policies (continued):

(g) Foreign exchange:

Transactions in foreign currencies are translated to the functional currency of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the exchange rate at the reporting date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at historical cost are translated using the exchange rate at the date of the transaction. 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.

(h) Leased assets:

All of the Company's leases are operating leases. The leased assets are not recognized in the Company's consolidated balance sheet since the Company does not assume substantially all risks and rewards of ownership of the leased assets.

Payments made under operating leases are recognized in income on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(i) Income taxes:

Deferred tax is recognized for temporary differences between the financial reporting bases and the income tax bases of the Company's assets and liabilities and is recorded using the substantively enacted tax rates anticipated to be in effect when the tax differences are expected to reverse. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously. A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3. Significant accounting policies (continued):

(j) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present, legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

Onerous contracts

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract, if applicable, and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

(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), net income is adjusted for the effect of gains and interest recognized for the period on the convertible notes and the resulting common shares are included for purposes of calculating diluted earnings per share.

(l) Employee benefits:

(i) Short-term employee benefits:

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Company has a present, legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

3. Significant accounting policies (continued):

(l) Employee benefits (continued):

(ii) Termination benefits:

Termination benefits are recognized as an expense when the Company is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. If benefits are payable more than twelve months after the reporting period, then they are discounted to their present value.

(iii) 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 at the date of grant and is expensed over the award's vesting period with a corresponding increase to equity. For the stock options with graded vesting, the fair value of each tranche is recognized over its respective 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. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and performance vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that meet the related service and performance conditions at the vesting date. For non-employees, the fair value of the options is remeasured and recognized over the service period.

When the stock options are exercised, the Company issues new shares. The proceeds received, together with the related portion previously recorded in contributed surplus, are credited to share capital.

The Company uses Deferred Share Units (DSU) for compensation of directors and designated employees. Upon termination of service, DSU participants are entitled to receive for each DSU credited to their account the payment in cash on the date of settlement based on the value of a BELLUS Health common share. 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 income.

3. Significant accounting policies (continued):

(m) Financial instruments:

Financial assets and liabilities are initially recognized at fair value and classified at inception as either loans and receivables, other financial liabilities or designated at fair value through profit and loss (FVTPL). Subsequently, financial instruments are measured in accordance with the measurement provision of the category to which they have been initially classified or designated. Transaction costs are expensed as incurred for financial instruments designated at FVTPL. For other financial instruments, transaction costs are accumulated on initial recognition and presented as a reduction of the underlying financial instruments. Financial assets and financial liabilities are classified at FVTPL if they are classified as held for trading or are designated as such upon initial recognition. Financial assets and liabilities at FVTPL are measured at fair value, and changes therein are recognized in income. Loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method.

The Company has designated or classified its financial instruments as follows:

Investments in New ABCP Notes are designated as FVTPL, as the contracts contain one or more embedded derivatives which would significantly modify the cash flows that otherwise would be required by the contract.

Cash and cash equivalents (consisting of fixed income securities), restricted cash not comprised of New ABCP Notes and Trade and other receivables are classified as loans and receivables.

Trade and other payables, credit facilities and Notes are classified as other financial liabilities.

Derivative instruments are recorded as either assets or liabilities measured at their fair value each period through income. Attributable transaction costs are recognized in income as incurred. 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.

Compound financial instruments

Compound financial instruments issued by the Company comprise mandatorily convertible preferred shares which entitle the holders to 6% cumulative yield, payable in cash or common shares at the then-market price, at the option of the Company.

3. Significant accounting policies (continued):

(m) Financial instruments (continued):

Compound financial instruments (continued)

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component is not remeasured subsequent to initial recognition.

Share Capital

Common shares and preferred shares that are not redeemable or are redeemable only at the Company's option are classified as equity. Incremental costs directly attributable to the issue of common and preferred shares are recognized as a deduction from the deficit, net of any tax effects.

4. Changes in accounting policies:

Future accounting changes:

(a) Financial Instruments:

IFRS 9, *Financial Instruments*, was issued in November 2009. It addresses classification and measurement of financial liabilities and replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is required to be applied for annual periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet assessed the impact of IFRS 9 or determined whether it will adopt the standard early.

4. Changes in accounting policies (continued):

Future accounting changes (continued):

(b) Consolidation:

IFRS 10, *Consolidated Financial Statements*, was issued in May 2011. IFRS 10 replaces the guidance in IAS 27, *Consolidated and Separate Financial Statements* and the interpretation of Standing Interpretations Committee (SIC) 12, *Consolidation – Special Purpose Entities (SPE)*. IAS 27 (2008) survives as IAS 27 (2011), *Separate Financial Statements*, only to carry forward the existing accounting requirements for separate financial statements. IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are SPE in the scope of SIC 12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008). This standard is required to be applied for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company does not expect IFRS 10 to have a material impact on the consolidated financial statements.

(c) Fair value measurement:

IFRS 13, *Fair Value Measurement*, was issued in May 2011. IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains ‘how’ to measure fair value when it is required or permitted by other IFRS. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. This standard is required to be applied prospectively for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of IFRS 13 or determined whether it will adopt the standard early.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

4. Changes in accounting policies (continued):

Future accounting changes (continued):

(d) Employee benefits:

In June 2011, the International Accounting Standards Board (IASB) published an amended version of IAS 19, *Employee Benefits*. The amendment impacts termination benefits, which would now be recognized at the earlier of when the entity recognizes costs for a restructuring within the scope of IAS 37, *Provisions*, and when the entity can no longer withdraw the offer of the termination benefits. This amendment is required to be applied for annual periods beginning on or after January 1, 2013, with early adoption permitted. The amendment is generally applied retrospectively with certain exceptions. The Company does not expect the amendment to IAS 19 to have a material impact on the consolidated financial statements.

5. Cash and cash equivalents:

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

	December 31, 2011	December 31, 2010	January 1, 2010
Cash balances with banks	$ 2,705	$ 4,290	$ 14,017
Short-term investments (yielding interest at 1.04% to 1.07% as at December 31, 2011) (December 31, 2010 - 0.11% to 0.18%)	2,400	5,967	–
	$ 5,105	$ 10,257	$ 14,017

6. Investments in New ABCP Notes:

In 2007, the Canadian third party asset-backed commercial paper (ABCP) market was hit by a liquidity disruption. A Pan-Canadian Investors Committee (the Committee) was established to oversee the restructuring of these instruments. In 2009, the Committee announced that the ABCP restructuring plan had been implemented pursuant to which holders of ABCP had their short-term commercial paper exchanged for longer-term notes. As of that date, the Company held a portfolio of ABCP issued by several trusts with overall notional value of $7,589 and US$5,977. The Company then received new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP, pursuant to the terms of the restructuring plan.

6. Investments in New ABCP Notes (continued):

As at December 31, 2011, the Company held New ABCP Notes having notional value of $6,023 and US$3,358, consisting of $2,299 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, US$3,281 of MAV3 IA Tracking Notes, as well as US$77 and $275 of MAV3 TA Tracking Notes. During the year ended December 31, 2011, the Company received partial payments for capital of $425, and for interest of $68 (2010 - $738 and $23, respectively).

In 2009, in connection with the restructuring of the ABCP market, the Company entered into secured revolving credit facilities with the chartered bank that sold the ABCP to the Company. These facilities mature in April 2013, with options to renew on an annual basis until April 2016. As of December 31, 2011, these credit facilities have combined maximum aggregate available amounts of approximately $8,797, which was fully drawn ($9,789 as of December 31, 2010, and $10,856 as of January 1, 2010, of which $92 was not drawn), bear interest at prime rate minus 1% per annum (weighted average effective interest rate was 2.25% in 2011 (2010 - 2.02%)), and are secured by an aggregate $18,400 hypothecs 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 and availability of these credit facilities decrease 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.

During the second quarter of 2011, the Company exercised its put option on one of the credit facilities, which reduced the aggregate credit facilities by $638, and the notional value of the New ABCP Notes by $850. This is a non-cash transaction, and therefore excluded from the consolidated statement of cash flows.

The investments in New ABCP Notes are measured at fair value in the consolidated financial statements. As at December 31, 2011, the Company estimated the fair value of the New ABCP Notes at approximately $6,006, of which $412 is presented as non-current Restricted cash in the consolidated balance sheet ($7,046 as at December 31, 2010, of which $379 is presented as non-current Restricted cash, and $7,240 as at January 1, 2010, of which $322 is presented as non-current Restricted cash), 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 determination, the Company recorded a decrease in fair value of $17 for the year ended December 31, 2011 (2010 - increase of $663), which is presented in Finance income (costs) in the consolidated statement of comprehensive income (loss).

6. Investments in New ABCP Notes (continued):

The Company estimated the fair value of the New ABCP Notes by discounting the expected cash flows at yields comparable to prevailing market yields and credit spreads available for securities with similar characteristics to the New ABCP Notes. The Company reviewed its assumptions to factor in new information available, as well as changes in market conditions. As at December 31, 2011, the Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.78% (weighted average rate of 0.71%), 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 five years and using discount rates ranging from 8.4% to 30% (weighted average rate of 15.1%).

In determining the fair value of certain series of New ABCP Notes, the Company took into account the put option feature included in the credit facilities. The fair value of the put options and change in fair value thereof are presented with New ABCP Notes and related change in fair value in the balance sheet and statement of comprehensive income (loss). The Company did not take into consideration market trades entered into on certain series of New ABCP Notes, as they are not considered to be sufficient to represent an active market. 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, 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 fair value each period, such adjustments would directly impact income.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

7. Equipment:

(a) Equipment consists of:

	Research equipment	Computer equipment	Office equipment	Total
Cost				
Balance January 1, 2010	$ 7,943	$ 3,491	$ 954	$ 12,388
Transfer to assets held for sale	(7,943)	–	(804)	(8,747)
Disposals	–	(1,591)	–	(1,591)
Balance December 31, 2010	–	1,900	150	2,050
Disposals	–	(1,472)	(55)	(1,527)
Balance December 31, 2011	$ –	$ 428	$ 95	$ 523
Accumulated depreciation and impairment losses				
Balance January 1, 2010	$ 5,972	$ 3,138	$ 683	$ 9,793
Depreciation for the year	230	145	73	448
Impairment loss	737	161	120	1,018
Transfer to assets held for sale	(6,939)	–	(771)	(7,710)
Disposals	–	(1,591)	–	(1,591)
Balance December 31, 2010	–	1,853	105	1,958
Depreciation for the year	–	24	22	46
Disposals	–	(1,472)	(55)	(1,527)
Balance December 31, 2011	$ –	$ 405	$ 72	$ 477
Carrying amounts				
At January 1, 2010	$ 1,971	$ 353	$ 271	$ 2,595
At December 31, 2010	–	47	45	92
At December 31, 2011	–	23	23	46

(in thousands of CDN dollars, except per share data, unless otherwise noted)

7. Equipment (continued):

(b) Assets held for sale

In connection with the restructuring announced on August 9, 2010 (see note 9 (a)), the Company implemented in 2010 a plan to sell its excess research and office equipment. 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 was recorded in 2010, and is presented on the following lines in the consolidated statement of comprehensive income (loss) for the year ended December 31, 2010: Research and development ($812) and General and administrative ($206). The remaining balance of these assets were sold in 2011 with no gain or loss recorded.

8. Trade and other payables:

Trade and other payables consist of:

	December 31, 2011	December 31, 2010	January 1, 2010
Trade payables	$ 60	$ 1,241	$ 740
Severance accrual (note 9 (a))	–	1,188	–
Other accrued liabilities	1,158	1,714	3,743
Deferred rent liability	–	3,031	–
Deferred share unit plan (note 13 (g))	269	880	1,133
Debt component of preferred shares (note 13 (d))	2,114	979	–
	$ 3,601	$ 9,033	$ 5,616

9. Restructuring charges:

(a) Workforce reduction:

On August 9, 2010, the Company announced that it would gradually reduce its workforce by more than two thirds, to focus on supporting its current and future strategic partnerships and in order to extend its cash resources. The one-time costs associated with this reduction, which totaled approximately $1,655, were recorded in the third quarter of 2010. These costs are presented on the following lines in the consolidated statement of comprehensive income (loss) for the year ended December 31, 2010: Research and development ($880) and General and administrative ($775). As at December 31, 2010, the provision related to the workforce reduction amounted to $1,188, and is presented in Trade and other payables in the consolidated balance sheet. The difference of $467 was paid during the year ended December 31, 2010.

(b) Lease of premises:

(i) Amendment to lease:

As a condition precedent to the 2009 Notes financing (refer to note 12 (a)), 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 (Termination Option). The Termination Option was exercised and the lease was terminated effective April 7, 2011 (refer to note 13 (c)).

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 (Deferred Rent). The Deferred Rent bore interest at the rate of ten percent (10%) annually. Deferred Rent and the accrued interest thereon were evidenced by promissory notes issued by BELLUS Health to its landlord on the first day of each month when such Deferred Rent became due. The promissory notes were 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 became payable. Deferred Rent and all notes evidencing Deferred Rent were settled on April 7, 2011, through the issuance of common shares from treasury (refer to note 13 (c)). The Company signed a new lease that began on April 8, 2011, at the same premises, for less space (refer to note 16 (a)). The promissory notes were financial liabilities classified as current Notes and warrant liability in the consolidated balance sheet; therefore, after initial recognition at fair value, they were accounted for at amortized cost (refer to note 12).

9. Restructuring charges (continued):

(b) Lease of premises (continued):

(i) Amendment to lease (continued):

The Company determined that the Termination Option constituted a material modification to the terms of the original lease. It concluded that the lease should continue to be classified as operating and that the lease term for accounting purposes would 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, were amortized on a straight-line basis to April 2011 for the portion of the premises that the Company continued to occupy. A portion of the deferred gain on sale of property and deferred rent liability was 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) Provision for vacant space (onerous contract):

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 which was terminated by the Company in January 2011. A net credit for vacant space was then recorded, which included 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. In addition, in August 2010, the Company further reduced its workforce and the portion of the premises occupied, and as a result, recorded a net expense for vacant space of $373 in General and administrative expenses in the consolidated statement of comprehensive income (loss).

(in thousands of CDN dollars, except per share data, unless otherwise noted)

9. Restructuring charges (continued):

(b) Lease of premises (continued):

(ii) Provision for vacant space (onerous contract) (continued):

Changes in the provision for lease for years ended December 31, 2011 and 2010 were as follows:

	Provision for lease
Balance as at January 1, 2010	$ 3,303
Adjustment to provision	685
Payments	(1,278)
Accretion expense	289
Balance as at December 31, 2010	2,999
Payments	(375)
Accretion expense	69
Exercise of Termination Option (b) (i)	(2,693)
Balance as at December 31, 2011	$ –

The net credit and net expense for vacant space were determined on the basis of the net present value of the provision for lease, the deferred gain on sale lease-back and the deferred rent liability, over the remaining lease period. The net expense accretion on the foregoing items for year ended December 31, 2011, amounted $69 (2010 - $176) and is presented in Finance costs in the consolidated statement of comprehensive income (loss). 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.

10. Revenues:

Revenues mainly consist of the following:

(a) On April 29, 2010, the Company entered into an asset sale and license agreement pursuant to which Celtic Therapeutics (Celtic) acquired and licensed worldwide rights related to the Phase III investigational product candidate KIACTA™ (eprodisate) for upfront payments totalling US$10,000, 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.

Under this agreement, Celtic is funding 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 entered into between the parties for an initial expected amount of $745 (US$745) receivable over the life of the agreement. Under this agreement, the Company provides support and assistance to Celtic in connection with their development plan of KIACTA™. In 2011, the Company's expected support and assistance to Celtic have increased, adjusting the expected amount receivable over the life of the agreement to $1,332 (US$1,351). As at December 31, 2011, the unbilled amount receivable amounts to $638, of which $466 is presented as current Prepaid expenses and other assets and $172 as non-current Prepaid expenses and other assets in the consolidated balance sheet (2010 - $532, $172 presented as current Prepaid expenses and other assets and $360 as non-current Prepaid expenses and other assets). Revenue adjustments in relation to a change in the expected amount to be received are recognized prospectively.

The Company determined that identifiable components related to the upfront payments and other monetary considerations under both agreements do not meet the requirements for separation and, as such, accounted for the combined components as a whole 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 at December 31, 2011, as that time period was considered to be management's best estimate of the pattern of performance of all its obligations under the agreements at that date. Subsequent to year-end, management's estimate of the period of the development phase was revised to 62 months to June 30, 2015. Revenue adjustments in relation to a change in the life of the agreement are recognized prospectively. The Company recognized revenues of $2,799 for the year ended December 31, 2011 (2010 - $1,805). The deferred revenue balances in the consolidated balance sheet represent unrecognized revenue in relation to those agreements.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

10. Revenues (continued):

(b) On December 31, 2010, the Company entered into a share purchase agreement with Advanced Orthomolecular Research Inc (AOR) for the sale of 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, which was recorded as revenue for the year ended December 31, 2010, and of a payment of $650 contingent upon the successful completion of a pre-established milestone event.

11. Long-term liabilities:

Long-term liabilities consist of:

	December 31, 2011	December 31, 2010	January 1, 2010
Deferred rent liability	$ –	$ –	$ 2,165
Advance from a government agency	–	112	127
Debt component of preferred shares (note 13 (d))	1,409	1,468	2,693
	$ 1,409	$ 1,580	$ 4,985

(in thousands of CDN dollars, except per share data, unless otherwise noted)

12. Notes and warrant liability:

Notes and warrant liability consist of the following:

	Notional value	Carrying value		
	December 31, 2011	December 31, 2011	December 31, 2010	January 1, 2010
15% Senior convertible notes due in 2014 (2009 Notes) (a)	$ 21,115 [1]	$ 22,290	$ 16,827	$ 12,705
Embedded conversion option on 2009 Notes (a)	–	2,670	15,775	9,871
6% Senior convertible notes due in 2026 (2006 Amended Notes) ((b) (i))	13,221	5,224	5,006	5,178
6% Senior convertible notes due in 2027 (2007 Amended Notes) ((b) (i))	509	209	201	208
Warrant liability ((b) (ii))	–	–	41	90
Deferred Rent promissory notes (refer to note 9 (b) (i))	–	–	3,678	1,531
Total	$ 34,845	30,393	41,528	29,583
Current portion – Deferred Rent promissory notes		–	(3,678)	–
Non-current portion		$ 30,393	$ 37,850	$ 29,583

[1] Excluding accrued interest of $9,951 as at December 31, 2011.

(a) 2009 Notes and embedded conversion option:

On April 16, 2009 and June 3, 2009, the Company issued to Vitus Investments III Private Limited (Vitus), a corporation whose shares are beneficially owned by M. Carlo Bellini, and Victoria Square Ventures Inc. (VSVI), a subsidiary of Power Corporation of Canada (together with Vitus, the Investors) convertible notes having a notional value of $21,115 (2009 Notes).

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 on the 2009 Notes accrues at the rate of 15% per year, compounded annually. The 2009 Notes mature in April 2014. At maturity, the notional value and the related accrued interest on the notes are payable in cash or common shares of the Company, at the option of the holder.

12. Notes and warrant liability (continued):

(a) 2009 Notes and embedded conversion option (continued):

The initial conversion price of the 2009 Notes at maturity was $0.20 per share (the Financing Conversion Price). The 2009 Notes include anti-dilution provisions with respect to the issuances of additional securities or distributions to shareholders whereby the initial Financing Conversion Price gets adjusted upon the occurrence of the events. In addition, should the Company issue additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, a "full ratchet" anti-dilution protection requires a downward adjustment to such Financing Conversion Price, subject to certain exceptions. The terms of the 2009 Notes have been amended in November 2011 to exclude from the "full ratchet" anti-dilution protection certain equity or equity-linked security issuances.

As of December 31, 2011, taking into consideration the shares issued by the Company since 2009, the Financing Conversion Price is $0.07 (Adjusted Financing Conversion Price) ($0.07 as at December 31, 2010 and $0.185 as at January 1, 2010). 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 the Company. 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 conversion option on the 2009 Notes contains various features which are considered multiple embedded derivatives under IAS 32, *Financial Statements: Presentation*, and are treated together as a single embedded derivative. The Company used a European Binomial option pricing model to determine the fair value of the embedded conversion option, which is then marked to market through the statement of comprehensive income (loss) at each reporting date. The difference between the value of the embedded conversion option and the notional value of the 2009 Notes was recognized as debt upon initial recognition.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

12. Notes and warrant liability (continued):

(a) 2009 Notes and embedded conversion option (continued):

Assumptions used in the valuation of the embedded conversion option are as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Expected dividend yield	nil	nil	nil
Risk-free interest rate	0.95%	2.01%	2.56%
Expected life in years	2.28	3.28	4.28
Expected volatility	88.07%	135.31%	107.30%
Share price	$ 0.045	$ 0.16	$ 0.18
Adjusted Financing Conversion Price	$ 0.07	$ 0.07	$ 0.185
Dilution factor	3.93	5.38	3.08
Fair value of option	$ 0.004	$ 0.026	$ 0.043
Number of shares issuable	606,711,529	606,711,529	229,566,524

The Company accretes the carrying values of the debt components of the 2009 Notes to their notional value and accrued interest to maturity through a charge to income recognized using the effective interest rate method over their contractual lives, which is 60 months. The unrecognized accretion expense on the 2009 Notes amounted to $20,180 as at December 31, 2011, and will be recognized over the remaining expected life of 28 months. The effective interest rate of the 2009 Notes is 28.47%.

The model used in the valuation of the embedded conversion option on the 2009 Notes contains certain subjective assumptions, changes to which could have cause significant variation in the initial estimated carrying value of the debt and could cause significant variation in the fair value of the embedded conversion option.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

12. Notes and warrant liability (continued):

(a) 2009 Notes and embedded conversion option (continued):

Changes in the 2009 Notes carrying value and the embedded conversion option for the years ended December 31, 2011 and 2011 were as follows:

	2009 Notes	Embedded conversion option
Balance as at January 1, 2010	$ 12,705	$ 9,871
Accretion expense	4,122	–
Change in fair value	–	5,904
Balance as at December 31, 2010	16,827	15,775
Accretion expense	5,463	–
Change in fair value	–	(13,105)
Balance as at December 31, 2011	$ 22,290	$ 2,670

(b) 2006 and 2007 Amended Notes and warrant liability:

(i) In connection with and as a condition to the 2009 Notes financing discussed in (a), the Company and all of the existing noteholders agreed in April 2009, to amend the terms of the then outstanding 2006 Notes and 2007 Notes (Original Notes). A portion of the Original Notes were converted into preferred shares. Refer to note 13 (d).

The remaining holders of US$13,000 principal amount of the 2006 Original Notes and one remaining holder of US$500 principal amount of the 2007 Original Notes agreed to amend the terms of their notes in 2009 (Amended Notes), without immediate conversion into preferred shares. The amendments provide for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of the Company at the then market price of the common shares and replacing the conversion rate adjustment period and redemption dates. The amendments to the notes also include the removal of certain negative covenants.

12. Notes and warrant liability (continued):

(b) 2006 and 2007 Amended Notes and warrant liability (continued):

(i) (continued):

The following are the 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 conversion rate of 62.3974 shares per US$1 principal amount of the notes (US$16.03 per share). The 2006 Amended notes are convertible, at the option of the holder, under the following conditions:

(a) 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;

(b) 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;

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

(d) 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 for a period of one month 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 Company’s 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.

The holders have the right to have the Company 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 notional value of the 2006 Amended Notes, plus any accrued and unpaid interest.

Since 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 notional value of the 2006 Amended Notes, plus any accrued and unpaid interest.

12. Notes and warrant liability (continued):

(b) 2006 and 2007 convertible notes and warrant liability (continued):

(i) (continued):

The following are the 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 of the Company at anytime since 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 the Company on January 17, 2014 and November 15, 2014, at a purchase price in cash equal to 100% of the then notional value of the 2007 Amended Notes, plus any accrued and unpaid interest.

The conversion options on the 2006 and 2007 Amended Notes contain various features which are considered multiple embedded derivatives under IAS 32 and are treated together as a single embedded derivative. The Company used an American Binomial option pricing model to determine the fair value of the embedded conversion options. As the conversion price of the 2006 and 2007 Amended Notes was deeply out-of-the money on initial recognition and remains deeply out of the money for all periods presented, the Company determined that the fair value of the embedded conversion options on the 2006 and 2007 Amended Notes was nominal, and allocated the entire fair value on initial recognition to the debt component. The Company also determined that the life of the 2006 and 2007 Amended Notes was 212 and 218 months, respectively.

The 2006 and 2007 Amended Notes are accreted to their notional value through a charge to income over their contractual life using the effective interest rate method. As at December 31, 2011, the unrecognized accretion expense amounted to $19,829 for the 2006 Amended Notes and $769 for the 2007 Amended Notes and will be recognized over the remaining expected lives of 179 and 185 months, respectively. The effective interest rate is 17.38% for the 2006 Amended Notes and 16.60% for the 2007 Amended Notes.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

12. Notes and warrant liability (continued):

(b) 2006 and 2007 convertible notes and warrant liability (continued):

(ii) As at December 31, 2011, warrants issued in connection with the 2007 Original Notes to purchase an aggregate of 17,191,674 common shares (December 31, 2010 - 14,560,287) of the Company until May 2, 2012, at a purchase price of US$1.66 per share (December 31, 2010 - US$1.96), are outstanding. The warrants include provisions in respect of issuances of securities or distributions to shareholders, which result in the adjustment of the number and exercise price of the warrants upon the occurrence of predetermined events.

The warrants meet the requirements for liability classification and are marked to market though the statement of comprehensive income (loss) at each reporting date.

The fair value of the warrants granted was determined using an American Binomial option pricing model with the following assumptions:

	December 31, 2011	December 31, 2010	January 1, 2010
Expected dividend yield	nil	nil	nil
Risk-free interest rate	0.90%	1.25%	1.69%
Expected life in years	0.33	1.33	2.33
Expected volatility	43.44%	98.34%	83.06%
Share price	$ 0.045	$ 0.16	$ 0.18
Exercise price	$ 1.69	$ 1.95	$ 2.20
Fair value of warrant	$ –	$ 0.003	$ 0.007

(in thousands of CDN dollars, except per share data, unless otherwise noted)

12. Notes and warrant liability (continued):

(b) 2006 and 2007 convertible notes and warrant liability (continued):

Changes in the 2006 Amended Notes, 2007 Amended Notes and warrant liability for the years ended December 31, 2011 and 2010, were as follows:

	2006 Amended Notes	2007 Amended Notes	Warrant liability
Balance as at January 1, 2010	$ 5,178	$ 208	$ 90
Accretion expense	893	35	–
Interest paid/payable	(793)	(31)	–
Change in fair value	–	–	(49)
Foreign exchange gain	(272)	(11)	–
Balance as at December 31, 2010	5,006	201	41
Accretion expense	869	32	–
Interest paid/payable	(769)	(29)	–
Change in fair value	–	–	(41)
Foreign exchange loss	118	5	–
Balance as at December 31, 2011	$ 5,224	$ 209	$ –

During the year ended December 31, 2011, accrued and unpaid interest due on the 2006 and 2007 Amended Notes of $778 and $30, respectively, were paid via the issuance of 13,519,810 common shares, at the then market price of the shares (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). These are non-cash transactions, and therefore excluded from the consolidated statement of cash flows.

The models used in the valuation of the embedded conversion options on the 2006 and 2007 Amended Notes and in the valuation of the warrants contain certain subjective assumptions, changes to which could have cause significant variation in the initial estimated carrying value of the debt and could cause significant variation in the fair value of the embedded conversion options and warrant liability.

The terms of the 2009 Notes and of the Amended 2006 and 2007 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 thousands of CDN dollars, except per share data, unless otherwise noted)

13. Share capital:

(a) The authorized share capital of the Company consists of:

- an unlimited number of voting common shares with no par value
- an unlimited number of non-voting preferred shares, issuable in one or more series, with no par value

(b) Issued and outstanding shares are as follows:

	Common shares		Preferred shares		Total
	Number	Dollars	Number	Dollars	Dollars
Balance, December 31, 2010	138,510,728	$ 358,770	79,211,160	$ 19,721	$ 378,491
Issued on exercise of Termination Option (c)	20,656,320	6,000	–	–	6,000
Issued in connection with payment of Deferred Rent (c)	34,242,911	4,290	–	–	4,290
Issued on payment of interests on convertible notes (note 12 (b))	13,519,810	808	–	–	808
Conversion of preferred shares into common shares (d)	318,281	68	(263,160)	(61)	7
Exercise of stock options for cash (e)	5,000	1	–	–	1
Balance, December 31, 2011	207,253,050	$ 369,937	78,948,000	$ 19,660	$ 389,597

	Common shares		Preferred shares		Total
	Number	Dollars	Number	Dollars	Dollars
Balance, January 1, 2010	110,439,105	$ 352,883	97,831,160	$ 23,959	$ 376,842
Issued on payment of interests on convertible notes (note 12 (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
Deferred tax related to items recognized in equity (refer to note 23 (e))	–	–	–	331	331
Balance, December 31, 2010	138,510,728	$ 358,770	79,211,160	$ 19,721	$ 378,491

13. Share capital (continued):

(c) Common shares:

On January 21, 2011, in consideration for the exercise of the Termination Option (refer to note 9 (b) (i)) of the lease of its Laval, Quebec premises, as provided in the amended lease agreement with the landlord of such premises, BELLUS Health issued 20,656,320 common shares from treasury to the landlord at a price of approximately $0.29 per share, for an aggregate value of $6,000.

On April 7, 2011, as final payment for the Deferred Rent (refer to 9 (b) (i)) payable by BELLUS Health to its landlord following the exercise of the Termination Option, the Company issued 34,242,911 common shares from treasury to the landlord of its Laval, Quebec, premises, at a price of approximately $0.125 per share, for an aggregate value of $4,290.

These are non-cash transactions, and therefore excluded from the consolidated statement of cash flows.

(d) Preferred shares:

In connection with the 2009 Notes financing, and as a condition thereto, the Company 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 Original Notes and US$4,000 principal amount of 2007 Original 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. As at December 31, 2011, 78,948,000 preferred shares are outstanding. The preferred shares are convertible at anytime into common shares on a one-to-one basis at the option of the holder, subject to adjustment; entitle the holders to 6% cumulative yield, 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.

The preferred shares possess both liability and equity attributes and therefore were accounted for as compound financial instruments with both a debt and an equity component. The debt component is classified in Trade and other payables and Long-term liabilities in the consolidated balance sheet. The accretion of the debt component amounted to $1,000 for the year ended December 31, 2011 (2010 - $807).

13. Share capital (continued):

(d) Preferred shares (continued):

During the year ended December 31, 2011, 263,160 preferred shares were converted into 318,281 common shares. Consequently, on conversion, the amounts of $61 and $7 were reclassified from preferred shares and Trade and other payables, respectively, to common shares (for the previous year, 18,620,000 preferred shares were converted into 20,554,365 common shares, for which amounts of $4,569 and $491 were reclassified from preferred shares and Trade and other payables, respectively, to common shares). These are non-cash transactions, and therefore excluded from the consolidated statement of cash flows.

(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.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

13. Share capital (continued):

(e) Stock option plan (continued):

Changes in outstanding options issued under the Stock Option Plan for the years ended December 31, 2011 and 2010, were as follows:

	Number	Weighted average exercise price
Options outstanding, January 1, 2010	4,719,341	$ 4.11
Granted [1]	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
Exercised	(5,000)	0.20
Forfeited	(1,210,945)	1.85
Expired	(55,958)	2.99
Options outstanding, December 31, 2011	9,210,258	$ 1.92

[1] For the year ended December 31, 2010, 6,381,000 options were granted to key management personnel, and 450,000 options were granted to other employees.

The following table summarizes information about options outstanding and exercisable as at December 31, 2011:

	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	3,393,500	$ 0.13	8.5	791,200	$ 0.13
$ 0.22 - $0.24	2,700,000	0.24	8.3	680,000	0.23
$ 1.50 - $2.07	2,360,600	1.52	6.2	1,756,360	1.52
$ 3.04 - $3.56	30,825	3.18	2.4	29,135	3.16
$ 6.79 - $6.93	123,000	6.86	3.0	110,600	6.85
$ 8.47 - $15.35	169,000	13.40	3.7	169,000	13.40
$17.40 - $23.35	276,333	19.55	3.5	258,066	19.64
$25.30 - $32.25	157,000	27.68	2.8	157,000	27.68
	9,210,258	$ 1.92	7.3	3,951,361	$ 3.91

(in thousands of CDN dollars, except per share data, unless otherwise noted)

13. Share capital (continued):

(e) Stock option plan (continued):

Stock-based compensation

The Company recorded stock-based compensation expense (excluding compensation under DSU plans) of $302 for the year ended December 31, 2011, of which $37 is presented in Research and development expenses and $265 is presented in General and administrative expenses, in the consolidated statement of comprehensive income (loss) (2010 – $623, $(95) presented in Research and development expenses and $718 presented in General and administrative expenses).

The fair value of each option granted is estimated on the date of grant using the Black-Scholes pricing model. Expected volatility is estimated by considering historic average share price volatility. The weighted average assumptions for options granted during the years ended December 31, 2011 and 2010, were as follows:

		2010	
	2011	Key management personnel [1]	Other employees [1]
Fair value of stock options at grant date	N/A	$ 0.15	$ 0.09
Five-day weighted average share price	N/A	$ 0.17	$ 0.10
Exercise price	N/A	$ 0.17	$ 0.10
Risk-free interest rate	N/A	2.85%	2.26%
Expected volatility	N/A	96%	96%
Expected life in years	N/A	7	7
Expected dividend yield	N/A	nil	nil

[1] For the year ended December 31, 2010, options to key management personnel were granted on January 11, 2010, May 26, 2010, and November 23, 2010, and options to other employees were granted on September 7, 2010.

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.

13. Share capital (continued):

(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, 2011, 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, 2011 and 2010, 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 (DSU) plans:

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.

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 comprehensive income (loss).

(in thousands of CDN dollars, except per share data, unless otherwise noted)

13. Share capital (continued):

(g) Deferred share unit (DSU) plans (continued):

Changes in the number of units for the years ended December 31, 2011 and 2010 were as follows:

Number of units	2011	2010
Balance, beginning of year	5,498,972	6,293,833
Units granted	633,727	199,574
Units paid	(166,681)	(765,486)
Units forfeited	–	(228,949)
Balance, end of year	5,966,018	5,498,972
Balance of DSU liability, included in Trade and other payables [(1)]	$ 269	$ 880

(1) Balance of DSU liability as at January 1, 2010, amounted to $1,133.

During the year ended December 31, 2011, the Company granted 633,727 DSUs (2010 – 199,574 DSUs), having a weighted average fair value per unit of $0.09 (2010 - $0.15). The net stock-based compensation expense (income) related to DSU plans recorded in the consolidated statement of comprehensive income (loss) for the year ended December 31, 2011, is $(594), of which $(67) is presented in Research and development expenses and $(527) is presented in General and administrative expenses (2010 - $(161), $(2) presented in Research and development expenses and $(159) presented in General and administrative expenses). For the year ended December 31, 2011, 166,681 units were redeemed for $17 (2010 – 765,486 units redeemed for $92).

(h) Incentive compensation agreements:

In 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 agreement remains subject to certain ongoing conditions, including TSX requirements. As a result of the workforce reduction (refer to note 9 (a)), the Company's obligation to potentially issue common shares under this incentive compensation agreement has been reduced by 1,312,500 common shares.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

13. Share capital (continued):

(h) Incentive compensation agreements (continued):

In 2010, the Board of Directors approved incentive compensation agreements whereby, 4,675,000 and 1,650,000 incentive compensation units were issued to the Board of Directors and employees, respectively. 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. As a result of employee departures, the Company's obligation to potentially issue common shares under the incentive compensation agreement to employees has been reduced by 475,000 units.

The measurement-date fair value of these shares and units, determined using a European Binomial model for barrier options taking into consideration the minimum market value target for the Company, is $0.03 per share and per unit. The significant inputs into the model were share price, expected life, expected volatility and risk-free interest rate as at December 31, 2011, with a nil dividend yield. During the years ended December 31, 2011 and 2010, the Company has not recorded any stock-based compensation in relation to these shares and units because the achievement of the targets is not currently considered probable.

14. Personnel expenses:

The aggregate compensation for the years ended December 31, 2011 and 2010, to personnel of the Company is set out below:

	2011	2010
Short-term benefits	$ 2,322	$ 4,857
Termination benefits	–	1,655
DSU plans expense	(559)	(151)
Stock option plan expense	314	730
	$ 2,077	$ 7,091

(in thousands of CDN dollars, except per share data, unless otherwise noted)

15. Net finance income (costs):

Finance income and Finance costs for the years ended December 31, 2011, and 2010, were attributed as follows:

		2011		2010
Interest income	$	108	$	152
Change in fair value of warrant liability (2007 Amended Notes)		41		49
Change in fair value of embedded conversion option on 2009 Notes		13,105		–
Change in fair value of New ABCP Notes		–		663
Foreign exchange gain		–		887
Finance income		13,254		1,751
Interest and bank charges		(340)		(527)
Accretion expense (notes 9 (b) (ii), 12 (a) and (b) and 13 (d))		(7,433)		(6,033)
Change in fair value of embedded conversion option on 2009 Notes		–		(5,904)
Change in fair value of New ABCP Notes		(17)		–
Foreign exchange loss		(248)		–
Finance costs		(8,038)		(12,464)
Net finance income (costs)	$	5,216	$	(10,713)

16. Commitments and contingencies:

(a) Operating leases:

Minimum annual lease payments for the next two years and thereafter are as follows:

2012	$	202
2013 and thereafter		78
	$	280

In addition, the Company is responsible for operating costs and taxes under the operating leases.

The property lease is a non-cancellable lease with a 24-month term, with rent payable monthly in advance, due to expire April 30, 2013.

16. Commitments and contingencies (continued):

(a) Operating leases (continued):

During the year ended December 31, 2011, a net amount of $435 was recognized as an expense in the statement of comprehensive income (loss) in respect of operating leases (2010 - $1,005). Refer to note 9 (b) for the lease of the Company's premises that was terminated on April 7, 2011.

(b) License agreements and research collaborations:

On February 1, 2006, the Company entered into an assignment agreement with Parteq Research and Development Innovations (Parteq), which was amended April 1, 2011 (the Assignment Agreement). Pursuant to the Assignment Agreement, Parteq agreed and assigned certain intellectual property to the Company for consideration, comprising an upfront payment and various deferred payment amounts. 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 pharmaceutical products, as well as other than pharmaceutical products, such as neutraceutical or natural health care products. Non-significant amounts are payable as at December 31, 2011 under this 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 a limited period after regulatory approval, subject to a maximum of $20,540. No amounts have been paid to date under this agreement.

(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 17 (b)) will be $250 in 2012, plus reimbursement of applicable expenses for services rendered under the agreement.

(d) Letter of credit:

As at December 31, 2011, the Company is contingently liable for a letter of credit in the amount of $465. New ABCP Notes and cash are pledged under this letter of credit and are presented as restricted cash in the consolidated balance sheet as at December 31, 2011.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

17. Related party transactions:

(a) There is no single ultimate controlling party.

(b) Dr. Francesco Bellini, Chairman of the Board of Directors, is providing ongoing advisory services to the Company under the terms of a consulting and services agreement between the Company and Picchio International, wholly-owned by Dr. Francesco Bellini and his spouse. 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, 2011 (2010 - $381).

In relation to the KIACTA™ asset sale and license agreement (refer to note 10), the Company also recorded fees of $261 (US$250) in 2010, paid to Dr. Francesco Bellini under the terms of the consulting and services agreement.

In 2010, the Company entered into a license and supply agreement relating to the distribution of VIVIMIND™ in Italy with FB Health Inc., a company controlled by Dr. Francesco Bellini. The Company recorded revenues of $88 under this agreement for the year ended December 31, 2011 (2010 - $63).

In 2004, the Company entered into an agreement to issue shares to Dr. Francesco Bellini, then Chief Executive Officer. Refer to note 13 (f).

(c) Key management personnel:

The Chief Executive Officer, Vice-Presidents and Directors of BELLUS Health are considered key management personnel.

The aggregate compensation for the years ended December 31, 2011 and 2010, to key management personnel of the Company is set out below:

	2011	2010
Short-term benefits	$ 1,496	$ 1,728
Termination benefits	–	381
DSU plans expense	(516)	(153)
Stock option plan expense	307	758
	$ 1,287	$ 2,714

(in thousands of CDN dollars, except per share data, unless otherwise noted)

18. Income taxes:

Deferred tax expense

		December 31, 2011		December 31, 2010
Origination and reversal of temporary differences	$	(2,008)	$	(335)
Change in unrecognized deductible temporary differences		2,008		335
Deferred tax expense	$	–	$	–

Reconciliation of effective tax rate:

		Year ended December 31, 2011		Year ended December 31, 2010
Net income (loss) for the year	$	3,424	$	(24,553)
Tax using the Company's domestic tax rate		972		(7,341)
Change in unrecognized deductible temporary differences		2,008		(335)
Effect of tax rates foreign jurisdictions		–		2,258
Non-deductible stock option expense		86		138
Permanent differences and other		(3,066)		5,280
Total tax expense	$	–	$	–

The applicable statutory tax rates are 28.4% in 2011 and 29.9% in 2010. The Company's applicable tax rate is the Canadian combined rates applicable in the jurisdiction in which the Company operates. The decrease is due to the reduction of the Federal income tax rate in 2011, from 18% to 16.5%.

Tax recognized directly in equity:

Deferred tax of $435 was recognized directly in equity in 2010 (refer to note 23 (e)).

(in thousands of CDN dollars, except per share data, unless otherwise noted)

18. Income taxes (continued):

Deferred tax assets and liabilities

Recognized deferred tax assets and liabilities:

As at December 31, 2011 and 2010, and January 1, 2010, deferred tax assets and liabilities are attributable to the following:

	Assets			Liabilities			Net		
	December 31, 2011	December 31, 2010	January 1, 2010	December 31, 2011	December 31, 2010	January 1, 2010	December 31, 2011	December 31, 2010	January 1, 2010
Research and development expense	$ –	$ 233	$ 689	$ –	$ –	$ –	$ –	$ 233	$ 689
Equipment	–	–	–	–	(233)	(612)	–	(233)	(612)
Deferred financing fees	–	–	–	–	–	(77)	–	–	(77)
Tax assets (liabilities)	–	233	689	–	(233)	(689)	–	–	–
Set off of tax	–	(233)	(689)	–	233	689	–	–	–
Net tax assets (liabilities)	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –

(in thousands of CDN dollars, except per share data, unless otherwise noted)

18. Income taxes (continued):

Deferred tax assets and liabilities (continued)

Unrecognized deferred tax assets:

As at December 31, 2011 and 2010, and January 1, 2010, the amounts and expiry dates of tax attributes and temporary differences for which no deferred tax assets was recognized were as follows:

	December 31, 2011		December 31, 2010			January 1, 2010		
	Canada		Canada			Canada		
	Federal[1]	Provincial[1]	Federal	Provincial	Foreign[2]	Federal	Provincial	Foreign[2]
	$	$	$	$	$	$	$	$
Research and development expenses, without time limitation	123,793	74,079	125,220	74,503	–	121,643	67,116	–
Federal research and development investment tax credits								
2019	18	–	–	–	–	–	–	–
2020	167	–	18	–	–	18	–	–
2021	230	–	167	–	–	167	–	–
2022	431	–	230	–	–	230	–	–
2023	314	–	431	–	–	431	–	–
2024	3,827	–	3,682	–	–	3,682	–	–
2025	3,954	–	4,399	–	–	4,399	–	–
2026	3,760	–	3,774	–	–	3,774	–	–
2027	4,104	–	4,031	–	–	4,031	–	–
2028	2,227	–	2,216	–	–	2,216	–	–
2029	1,262	–	1,368	–	–	1,353	–	–
2030	759	–	839	–	–	–	–	–
2031	87	–	–	–	–	–	–	–
	21,140	–	21,155	–	–	20,301	–	–
Tax losses carried forward								
2011	–	–	–	–	56,394	–	–	56,394
2012	1,660	1,598	1,680	1,925	62,248	1,680	1,925	62,248
2013	–	–	1,660	1,598	76,927	1,660	1,598	76,927
2014	–	–	–	–	108,019	–	–	108,019
2015	–	–	–	–	78,279	–	–	78,279
2016	–	–	–	–	26,114	–	–	26,114
2017	–	–	–	–	5,252	–	–	5,252
2023	3,786	4,217	–	–	–	–	–	–
2024	3,410	3,637	3,786	4,217	–	3,786	4,217	–
2025	2,012	1,786	3,410	3,637	–	3,410	3,637	–
2026	6,887	7,734	2,012	1,785	–	2,012	1,785	–
2027	1,437	1,367	6,887	7,734	–	6,887	7,734	–
2028	991	991	1,437	1,367	–	9,236	9,157	–
2029	335	335	991	991	–	9,610	9,610	–
2030	2,262	1,886	701	557	–	–	–	–
2031	16,149	16,014	–	–	–	–	–	–
	38,929	39,565	22,564	23,811	413,233	38,281	39,663	413,233
Other deductible temporary differences, without time limitation	34,642	34,598	23,511	23,332	49,777	13,057	12,722	49,209

(1) In 2011, BELLUS Health completed a corporate reorganization, which triggered a deemed year-end for the Company's subsidiary.

(2) The corporate reorganization in 2011, whereby the Company streamlined its international structure by liquidating its subsidiaries in Europe and the United Sates, caused the Company's losses and other deductible temporary differences in those jurisdictions to no longer be available.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

18. Income taxes (continued)

Deferred tax assets and liabilities (continued)

Unrecognized deferred tax assets (continued):

Deferred tax assets have not been recognized in respect to these items because it is not probable that future taxable profit will be available against which the Company can utilize the benefits therefrom. The generation of future taxable profit is dependent on the successful commercialization of the Company's products and technologies.

19. Earnings (loss) per share:

	Year ended December 31, 2011	Year ended December 31, 2010
Basic earnings (loss) per share:		
Basic weighted average number of common shares outstanding	266,376,216	211,341,161
Basic net earnings (loss) per share	$ 0.01	$ (0.12)
Diluted loss per share:		
Net income (loss) for the period	$ 3,424	$ (24,553)
Adjustments for dilutive impacts of 2009 Notes	(7,642)	–
Net loss for calculation of diluted loss per share	$ (4,218)	$ (24,553)
Basic weighted average number of common shares outstanding	266,376,216	211,341,161
Plus dilutive impact of 2009 Notes	385,914,330	–
Diluted weighted average number of common shares outstanding	652,290,546	211,341,161
Diluted net loss per share	$ (0.01)	$ (0.12)

19. Earnings (loss) per share (continued):

As the preferred shares are automatically converted into common shares at maturity, if not before, 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 of the total 220,000 common shares to be issued to Dr. Francesco Bellini upon achievement of specified performance targets. The shares will be issued upon formal notification.

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

20. Segment disclosures:

(a) Business segment:

The Company operates in one business segment, the development of products for health solutions. As at December 31, 2011, the Company's operations are conducted essentially in Canada, following the completion of the corporate reorganization whereby the Company streamlined its international structure by liquidating its subsidiaries in Europe and the United States on March 31, 2011. Essentially all the Company's non-current assets are located in Canada.

(b) Significant sources of revenue:

In 2011, 91% of revenues come from Celtic (2010 – 75%) (see note 10).

21. 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.

21. Capital disclosures (continued):

The Company issued common shares for the payment of interest on the 2006 and 2007 Amended Notes (refer to note 12 (b)), as well as for the exercise of the Termination option and the settlement of the Deferred Rent (refer to note 9 (b) (i)).

The Company defines capital to include total shareholders' deficiency and notes.

As at December 31, 2011, the Company had Notes and warrant liability in the amount of $30,393, with an aggregate notional value of the Notes of $34,845.

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

As at December 31, 2011, cash and cash equivalents amounted to $5,105. 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 (refer to note 2 (d)).

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.

22. 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.

Financial assets and liabilities fair valued on a recurring basis, as at December 31, 2011 and 2010 and January 1, 2010, are the investments in New ABCP Notes (including those presented in restricted cash), the embedded conversion option on 2009 Notes and the warrant liability, all measured using Level 3 inputs.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

22. Financial instruments (continued):

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

For the years ended December 31, 2011 and 2010, 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:

	Investments in New ABCP Notes and restricted cash	Warrant Liability	Embedded conversion option on 2009 Notes
Balance as at January 1, 2010	$ 7,240	$ (90)	$ (9,871)
Proceeds	(761)	–	–
Foreign exchange loss	(96)	–	–
Total gain (loss) included in income (reported as change in fair value)	663	49	(5,904)
Balance as at December 31, 2010	7,046	(41)	(15,775)
Proceeds	(425)	–	–
Exercise of put option	(638)	–	–
Foreign exchange gain	40	–	–
Total (loss) gain included in income (reported as change in fair value)	(17)	41	13,105
Balance as at December 31, 2011	$ 6,006	$ –	$ (2,670)

The amount presented above as total (loss) gain included in income attributable to the change in fair value of the related assets and liabilities still held at reporting date was unrealized.

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 credit facilities approximates fair value as they bear interest at variable rates. The carrying value of the financial liabilities included in long-term liabilities also approximates fair value. The fair value of the other financial liabilities included in convertible notes is estimated based on discounting expected future cash flows at estimated current market interest rates for the instruments. Current market rates are determined by reference to current benchmark rates for a similar term and current credit spreads for debt with similar terms and risk.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

22. Financial instruments (continued):

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

The carrying values and fair values of the convertible notes are summarized as follows:

	December 31, 2011		December 31, 2010		January 1, 2010	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
FVTPL	$ 2,670	$ 2,670	$ 15,775	$ 15,775	$ 9,871	$ 9,871
Other financial liabilities	27,723	27,681	22,034	19,759	18,091	14,611
Total	$ 30,393	$ 30,351	$ 37,809	$ 35,534	$ 27,962	$ 24,482

(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, restricted cash and investments 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, 2011, the Company's maximum credit exposure corresponded to the carrying amount of these financial assets.

Refer to note 6 for credit risk related to investments in New ABCP Notes and restricted cash.

(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 21. 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 note 2 (d) with respect to material uncertainty in regards to the Company's liquidity.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

22. Financial instruments (continued):

(c) Liquidity risk (continued):

The following are the contractual maturities of financial liabilities as at December 31, 2011:

	Carrying amount	Contractual cash flows	Less than 1 year	2 to 3 years	Greater than 3 years
Credit facilities [1]	$ 8,797	$ 9,670	$ 202	$ 403	$ 9,065
Trade and other payables [2]	3,332	5,886	1,218	4,668	–
Financial liabilities included in long-term liabilities [2]	1,409	3,112	–	3,112	–
Notes [3]	30,393	57,882	824	57,058	–
	$ 43,931	$ 76,550	$ 2,244	$ 65,241	$ 9,065

[1] Assuming interest calculated at the interest rate in effect at the balance sheet date and notional repayment based on available renewal options of the Company. Should the chartered bank not agree to renew the credit facilities, the Company would have a cash exposure for the difference between the outstanding amount of the credit facilities and the proceeds from the sale of the New ABCP Notes or exercise of put option features of these credit facilities.

[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 revenues and 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. 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.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

22. 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, 2011:

(in CDN dollars)	December 31, 2011
	$US
Cash and cash equivalents	1,110
Trade and other receivables	48
Prepaid expenses and other assets (current)	466
Investments New ABCP Notes	2,066
Prepaid expenses and other assets (non-current)	172
Trade and other payables	(2,492)
Credit facilities	(3,421)
Long-term liabilities	(1,409)
Notes and warrant liability	(5,433)
	(8,893)

The following exchange rates were applied during the year ended December 31, 2011:

	Average rate	Reporting date rate
$US per $CDN	1.0109	0.9833

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 increase the net income as follows, assuming that all other variables remained constant:

	$US
Increase in net income	889

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.

22. 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
Investments 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, 2011, an assumed 1% increase or 1% decrease in interest rates during such period would have had no significant effect on income.

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 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 comprehensive income (loss) represents interest income on financial assets classified as loans and receivables.

23. Impact of first time adoption of IFRS:

As stated in note 2 (a), these are the Company's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in note 3 have been applied in preparing the consolidated financial statements for the year ended December 31, 2011 and the comparative information presented in these consolidated financial statements for the year ended December 31, 2010 and in the preparation of an opening IFRS statement of financial position at January 1, 2010 (the Company's date of transition).

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in consolidated financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Company's consolidated financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

		December 31, 2010				January 1, 2010			
	Note	Previous Canadian GAAP	Reclassi-fication and adjust-ments (note (a))	Effect of transition to IFRS	IFRS	Previous Canadian GAAP	Reclassi-fication and adjust-ments (note (a))	Effect of transition to IFRS	IFRS
Assets									
Current assets:									
Cash and cash equivalents		$ 10,257	$ –	$ –	$ 10,257	$ 14,017	$ –	$ –	$ 14,017
Restricted cash		281	–	–	281	–	–	–	–
Trade and other receivables		156	–	–	156	378	–	–	378
Assets held for sale	(b)	155	419	–	574	–	–	–	–
Research tax credit receivable		1,953	–	–	1,953	3,618	–	–	3,618
Prepaid expenses and other assets		712	172	–	884	971	–	–	971
Total current assets		13,514	591	–	14,105	18,984	–	–	18,984
Non-current assets:									
Assets held for sale	(b)	419	(419)	–	–	–	–	–	–
Investments in New ABCP Notes		6,667	–	–	6,667	6,918	–	–	6,918
Restricted cash		379	–	–	379	704	–	–	704
Prepaid expenses and other assets		–	360	–	360	150	–	–	150
Equipment		92	–	–	92	2,595	–	–	2,595
Total non-current assets		7,557	(59)	–	7,498	10,367	–	–	10,367
Total Assets		$ 21,071	$ 532	$ –	$ 21,603	$ 29,351	$ –	$ –	$ 29,351
Liabilities and Shareholders' Deficiency									
Current liabilities:									
Trade and other payables	(c)	$ 10,942	$ (1,906)	$ (3)	$ 9,033	$ 4,667	$ 949	$ –	$ 5,616
Provision	(c)	–	2,786	213	2,999	–	184	707	891
Deferred gain on sale of property	(c)	1,241	–	(65)	1,176	6,001	–	(592)	5,409
Deferred revenue		2,580	123	–	2,703	–	–	–	–
Notes and warrant liability		3,678	–	–	3,678	–	–	–	–
Total current liabilities		18,441	1,003	145	19,589	10,668	1,133	115	11,916
Non-current liabilities:									
Credit facilities		9,789	–	–	9,789	10,764	–	–	10,764
Deferred gain on sale of property	(c)	–	–	–	–	1,351	–	(183)	1,168
Deferred revenue		6,040	409	–	6,449	–	–	–	–
Long-term liabilities	(c)	2,460	(880)	–	1,580	8,408	(3,370)	(53)	4,985
Provision	(c)	–	–	–	–	–	2,237	175	2,412
Notes and warrant liability	(d)	20,937	–	16,913	37,850	17,350	–	12,233	29,583
Total non-current assets		39,226	(471)	16,913	55,668	37,873	(1,133)	12,172	48,912
Total liabilities		57,667	532	17,058	75,257	48,541	–	12,287	60,828
Shareholders' Deficiency:									
Share capital	(e) (h)	387,540	–	(9,049)	378,491	386,222	–	(9,380)	376,842
Equity portion of convertible notes	(d)	12,901	–	(12,901)	–	12,901	–	(12,901)	–
Contributed surplus	(d) (f) (g) (h)	27,442	–	(4,482)	22,960	26,053	–	(3,716)	22,337
Warrants	(d)	18,699	–	(18,699)	–	18,699	–	(18,699)	–
Deficit	(j)	(477,629)	–	22,524	(455,105)	(457,516)	–	26,860	(430,656)
Accumulated other comprehensive income	(h)	(5,549)	–	5,549	–	(5,549)	–	5,549	–
Total deficiency attributable to equity Holders		(36,596)	–	(17,058)	(53,654)	(19,190)	–	(12,287)	(31,477)
Total Liabilities and Shareholders' Deficiency		$ 21,071	$ 532	$ –	$ 21,603	$ 29,351	$ –	$ –	$ 29,351

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

		Year ended December 31, 2010			
	Note	Previous Canadian GAAP	Reclassi-fication	Effect of transition to IFRS	IFRS
			(note (a))		
Revenues		$ 2,408	$ –	$ –	$ 2,408
Expenses:					
Research and development	(f)	8,464	1,224	(217)	9,471
Research tax credits and grants		(1,409)	–	–	(1,409)
		7,055	1,224	(217)	8,062
General and administrative	(i)	7,078	1,556	(448)	8,186
Stock-based compensation		1,228	(1,228)	–	–
Depreciation and equipment write-off		1,466	(1,466)	–	–
Net expense for vacant space		272	(272)	–	–
		17,099	(186)	(665)	16,248
Results from operating activities		(14,691)	186	665	(13,840)
Interest income		152	(152)	–	–
Interest and bank charges		(527)	527	–	–
Accretion expense		(6,717)	6,717	–	–
Change in fair value of embedded derivatives		19	(19)	–	–
Change in fair value of New ABCP Notes		663	(663)	–	–
Foreign exchange gain		988	(988)	–	–
Finance income	(d)	–	1,822	(71)	1,751
Finance costs	(i)	–	(7,430)	(5,034)	(12,464)
Net finance (costs) income		(5,422)	(186)	(5,105)	(10,713)
Net loss and total comprehensive loss attributable to owners of the Company		$ (20,113)	$ –	$ (4,440)	$ (24,553)
Loss per share:					
Basic and diluted		$ (0.10)	$ –	$ (0.02)	$ (0.12)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations:

(a) Reclassification and adjustments in the consolidated balance sheets and consolidated statements of comprehensive income (loss):

Certain corresponding figures as at December 31, 2010 and January 1, 2010 have been reclassified or adjusted to conform to the new presentation under IFRS. Under IFRS, the Company elected to present expenses in the consolidated statement of comprehensive income (loss) using a classification based on their function, and accretion expense on onerous contract is presented in Finance costs whereas it was presented under General and administrative expenses under previous Canadian GAAP. Under IFRS, provisions are presented as a separate line item on the balance sheet.

(b) Assets held for sale:

Under previous Canadian GAAP, assets held for sale were presented in non-current assets, and only the portion of the assets sold between the reporting date and the date of completion of the consolidated financial statements was reclassified in current assets.

Under IFRS, assets held for sale must be presented in current assets in the consolidated balance sheet. The Company had assets held for sale amounting to $419 in non-current assets as at December 31, 2010, which has been reclassified in current assets under IFRS.

(c) Lease:

(i) Provision for lease:

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, introduces the concept of an onerous contract which should be recorded as a liability. The Company's lease exit obligation under previous Canadian GAAP is considered an onerous contract under IFRS. Under IFRS, the discount rate used to determine the provision is different than under previous Canadian GAAP and the provision is then remeasured each period with changes in estimates including the applicable discount rate. The onerous lease provision and other lease-related credits for the portion related to the onerous lease were remeasured with the discount rate in effect at transition and during fiscal 2010.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

c) Lease (continued):

(ii) Deferred gain on sale of property:

Under IAS 17, *Leases*, a sale and leaseback transaction that results in an operating lease may give rise to a profit or a loss, the determination and treatment of which depends on the leased asset's carrying amount, fair value and selling price. The excess profit (the excess of sale price over fair value) is deferred and amortized over the period for which the asset is expected to be used. Any excess of fair value over carrying amount is recognized immediately in the consolidated statement of comprehensive income (loss). This excess would have been recognized in income at the time of the transaction under IFRS but was deferred and amortized over the lease term under previous Canadian GAAP. The previous Canadian GAAP unamortized gain of $146 is reversed on transition and the amortization of the gain is reversed in income in 2010.

The impact of these changes is summarized as follows:

Consolidated Balance Sheets	December 31, 2010	January 1, 2010
Decrease in deferred rent liability (Trade and other payables)	$ (3)	$ –
Increase in Provision (current)	213	707
Decrease in deferred rent liability (Long-term liabilities)	–	(53)
Increase in Provision (non-current)	–	175
Decrease in Deferred gain on sale of property (current)	(65)	(592)
Decrease in Deferred gain on sale of property (non-current)	–	(183)
Increase in Deficit	$ 145	$ 54

Consolidated Statements of Comprehensive Income (Loss)	Year ended December 31, 2010
Decrease in Finance costs	$ (10)
Increase in General and administrative expenses	101
Decrease in net income	$ 91

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

(d) Notes and warrants:

(i) Convertible notes:

IFRS 1, *First-time Adoption of International Financial Reporting Standards*, do not provide exemption to the respective application of IAS 32, *Financial Instruments: Presentation,* for instruments that are outstanding at the date of transition. IAS 32 provides guidance with regards to the classification of financial instrument as debt or equity.

The Company has three outstanding series of convertible notes at the date of transition whereby the classification under IFRS was assessed following the guidance in IAS 32, namely, the 2009 Notes, the 2006 Amended Notes and the 2007 Amended Notes.

Under previous Canadian GAAP, those three convertible notes were treated as compound instruments containing a debt and an equity component. On initial recognition of the notes the proceeds received or the fair value of the notes, in the case of the 2006 and 2007 Amended Notes, were allocated to their component parts based on the residual method to equity. The amount recorded in equity for the above notes was not re-measured subsequent to their initial recognition under previous Canadian GAAP.

At the date of transition, the Company determined that the equity component of the notes under previous Canadian GAAP did not meet the definition of equity under IAS 32. Therefore, the conversion options related to those notes are now treated as derivative liabilities under IFRS with changes in fair value recognized in income at each reporting date.

As a result, the Company recalculated the allocation of proceeds or fair value to each of the instruments' parts at the date the Company became a party to the instrument and the fair value of the conversion options was determined first with the residual allocated to the debt components. As a result, the carrying amount of the debt components under IFRS is different then the carrying amount of the debt under previous Canadian GAAP, and the accretion expense was modified to reflect the new allocation on initial recognition. The debt components continue to be recorded at amortized cost.

As the conversion price of the 2006 and 2007 Amended Notes was deeply out-of-the money on initial recognition and remains deeply out-of-the money to date, the Company determined that the fair value of the conversion options of the 2006 and 2007 Amended Notes was nominal and allocated the entirety of the fair value on initial recognition to the debt component.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

(d) Notes and warrants (continued):

(i) Convertible notes (continued):

In April 2009, the 2006 and 2007 Original Notes were refinanced and the Company concluded that the modification should be accounted for as an extinguishment under both previous Canadian GAAP and IFRS. The related conversion options classified in equity under previous Canadian GAAP were reclassified to Contributed surplus whereas the amount related to the conversion options would have been classified in Deficit under IFRS. The Company reclassified these Contributed surplus amounts to Deficit to conform to the IFRS treatment.

(ii) Warrants:

In 2007, the Company issued warrants that are still outstanding at the date of transition. Under previous Canadian GAAP, these warrants were recorded at their initial fair value in shareholder's equity and were not re-measured subsequently. As discussed in note 23 (d) (i) above, on transition to IFRS, the Company is required to determine whether these warrants meets the definition of equity instrument under IAS 32.

The Company determined that the warrants do not meet the definition of equity under IFRS as their exercise does not result in the delivery of a fixed amount of shares for a fixed amount of cash. As a result, the warrants had to be reclassified as a liability and accounted for as freestanding derivative financial instruments with changes in fair value recognized in income at each reporting date.

The impact of these changes is summarized as follows:

Consolidated Balance Sheets	December 31, 2010	January 1, 2010
Increase in Notes and warrant liability	$ 16,913	$ 12,233
Decrease in Equity portion of convertible notes	(12,901)	(12,901)
Decrease in Contributed surplus	(3,375)	(3,375)
Decrease in Warrants	(18,699)	(18,699)
Decrease in Deficit	$ (18,062)	$ (22,742)

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

(d) Notes and warrants (continued):

Consolidated Statements of Comprehensive Income (Loss)	Year ended December 31, 2010
Decrease in Finance income	$ (71)
Increase in Finance costs	(4,609)
Decrease in net income	$ (4,680)

(e) Deferred tax liability:

Under IAS 12, *Income Taxes*, the adjustment of the deferred tax liability would be recognized outside of profit and loss if the tax relates to items that are recognized in the same or different period, outside profit and loss. Under previous Canadian GAAP, the adjustment was recorded through accretion expense in income. This adjustment results in an increase in Share capital of $331 as at December 31, 2010, with a corresponding increase in Deficit and an increase in Finance costs of $435.

(f) Stock-based compensation expense:

The Company issues stock-based awards in the form of stock options that vest evenly over a five-year period. Under previous Canadian GAAP, the Company recognized 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 resulted in the amount for each grant expensed at a faster rate than under previous Canadian GAAP. The Company adjusted the stock-based compensation expense under IFRS 2, *Share-based Payment*, whereby only unvested options as at January 1, 2010, were adjusted as required by IFRS 1, *First-time Adoption of International Financial Reporting Standards.*

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

(f) Stock-based compensation expense (continued):

The impact of these changes is summarized as follows:

Consolidated Balance Sheets	December 31, 2010	January 1, 2010
(Decrease) increase in Contributed surplus	$ (196)	$ 570
(Decrease) increase in Deficit	$ (196)	$ 570

Consolidated Statements of Comprehensive Income (Loss)	Year ended December 31, 2010
Decrease in Research and development expenses	$ 217
Decrease in General and administrative expenses	549
Increase in net income	$ 766

(g) Acquisition of Innodia:

In 2008, the Company acquired 100% of the remaining outstanding capital stock that it did not already own of Innodia Inc. (Innodia).

Concurrent with the acquisition, the non-controlling interest in Innodia Holdings, a variable interest entity of which the Company was the primary beneficiary, was acquired by the Company. As the transaction was between related parties, the settlement of the non-controlling interest was credited to additional paid-in capital under previous Canadian GAAP.

Under IFRS, the Company determined that it did not control Innodia Holdings and as a result it would not have been consolidated. Innodia Holdings would have been recorded as an investment under IFRS and no non-controlling interest would have been recorded in the financial statements of the Company. Upon the acquisition of the remainder of Innodia, the removal of the investment in Innodia Holdings would have been part of the consideration to be allocated to the net assets acquired. As at that time the value of such investment would have been nil; the impact on transition and subsequent balance sheets is to reverse the Contributed surplus recorded under previous Canadian GAAP of $700 with a corresponding decrease in Deficit.

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to the reconciliations (continued):

(h) Foreign currency translation:

Effective July 1, 2007, the Company adopted the US dollar as its functional and reporting currency, and effective January 1, 2010, the Company adopted the Canadian dollar as its functional and reporting currency. Under previous Canadian GAAP, assets and liabilities were translated at the exchange rate on July 1, 2007 and on January 1, 2010, respectively, and equity transactions were translated at historical rates.

Under IFRS, the Company's change in functional currency must be accounted for prospectively from the date of change. As at July 1, 2007 and as at January 1, 2010, all items of the then-consolidated balance sheet were translated at the foreign exchange rate in effect on that date. This difference resulted in Accumulated other comprehensive income of nil, and corresponding reclassifications amounting to $5,549 within equity on transition.

Amounts of $9,380, $211 and $(4,042) have been reclassified to Share capital, Contributed surplus and Deficit, respectively, on transition and subsequent balance sheet dates:

Consolidated Balance Sheets	December 31, 2010	January 1, 2010
Decrease in Share capital	$ (9,380)	$ (9,380)
Decrease in Contributed surplus	(211)	(211)
Increase in Accumulated other comprehensive income	5,549	5,549
Decrease in Deficit	$ (4,042)	$ (4,042)

(i) Consolidated statements of comprehensive income (loss):

The impact of the above changes in the consolidated statements of comprehensive income (loss) is summarized as follows:

General and administrative expenses	Year-ended December 31, 2010
Lease (c)	$ 101
Stock-based compensation expense (f)	(549)
Decrease in General and administrative expenses	$ (448)

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to reconciliations (continued):

(i) Consolidated statements of comprehensive income (loss):

Finance costs	Year-ended December 31, 2010
Lease (c)	$ 10
Notes and warrants (d)	(4,609)
Deferred tax liability (e)	(435)
Increase in Finance costs	$ (5,034)

(j) Consolidated statement of shareholders' deficiency:

The impact of the above changes in equity in the consolidated balance sheet is summarized as follows:

Deficit	December 31, 2010	January 1, 2010
Lease (c)	$ (145)	$ (54)
Notes and warrants (d)	18,062	22,742
Deferred tax liability (e)	(331)	–
Stock-based compensation expense (f)	196	(570)
Acquisition of Innodia (g)	700	700
Foreign currency translation (h)	4,042	4,042
Decrease in Deficit	$ 22,524	$ 26,860

Share capital	December 31, 2010	January 1, 2010
Deferred tax liability (e)	$ 331	$ –
Foreign currency translation (h)	(9,380)	(9,380)
Decrease in Share capital	$ (9,049)	$ (9,380)

(in thousands of CDN dollars, except per share data, unless otherwise noted)

23. Impact of first time adoption of IFRS (continued):

Notes to reconciliations (continued):

(j) Consolidated statement of shareholders' deficiency:

Contributed surplus	December 31, 2010	January 1, 2010
Notes and warrants (d)	$ (3,375)	$ (3,375)
Stock-based compensation expense (f)	(196)	570
Acquisition of Innodia (g)	(700)	(700)
Foreign currency translation (h)	(211)	(211)
Decrease in Contributed surplus	$ (4,482)	$ (3,716)

(k) Other IFRS 1 exemptions:

The Company applied the fair value measurement provisions of financial assets and financial liabilities at initial recognition in IAS 39, *Financial Instruments: Recognition and Measurement,* prospectively for transactions occurring on or after the date of transition, as permitted by an amendment to IFRS 1 issued in December 2010 and early-adopted as of January 1, 2010.

(l) Material adjustments to the consolidated statement of cash flows:

Consistent with the Company's accounting policy choice under IAS 7, *Statement of Cash Flows*, interest received has been classified as investing activities and interest paid has been classified as financing activities. Interest paid has been presented in the body of the consolidated statement of cash flows, whereas it was previously disclosed as supplementary information. There are no other material differences between the consolidated statement of cash flows presented under IFRS and the consolidated statement of cash flows presented under previous Canadian GAAP.

SHAREHOLDER INFORMATION

EXECUTIVE MANAGEMENT

Mr. Roberto Bellini
President and
Chief Executive Officer

—

Dr. Denis Garceau
Senior Vice President,
Drug Development

—

Mr. François Desjardins, CA
Vice President,
Finance

—

Mr. Tony Matzouranis
Vice President,
Business Development

BOARD OF DIRECTORS

Dr. Francesco Bellini, O.C.
Chairman of the Board
BELLUS Health Inc.

—

Mr. Charles Cavell
Deputy Chairman of the Board

—

Mr. Roberto Bellini
President and
Chief Executive Officer
BELLUS Health Inc.

—

Mr. Franklin Berger, CFA
Consultant

—

Mr. Neil Flanzraich
Executive Chairman
ParinGenix, Inc. and
Tigris Pharmaceuticals, Inc.

—

Ms. Hélène Fortin, FCA
Partner
Larose Fortin CA Inc.,
Chartered Accountants

—

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

—

Mr. Joseph Rus
Consultant

—

Dr. Martin Tolar
President and
Chief Executive Officer
Knome, 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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STOCK LISTING

Toronto Stock Exchange (TSX)
Symbol: BLU

CORPORATE PROFILE

BELLUS Health is a development-focused health company concentrating on the 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. In addition, we are commercializing VIVIMIND™, a naturel health product designed to protect memory function, through distributors.

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