

# MANAGEMENT'S REPORT

The consolidated financial statements of Theratechnologies Inc. presented in the following pages and all information in this annual report are the responsibility of management and have been approved by the Board of Directors of the Company.

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. They include amounts based on exercise of judgment and on estimates. Management has established these amounts reasonably to ensure that financial results are presented accurately in all material respects. The other financial information included in the annual report is consistent with that of the financial statements.

In order to ensure accuracy and objectiveness of information included in the financial statements, the Company's management maintains internal accounting and administrative control systems. Management is of the opinion that these controls provide reasonable assurance regarding the adequacy of the accounting records for the preparation of the financial statements and the adequacy of the recording and safeguarding of assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee is appointed by the Board, and none of its members is involved in the daily operations of the Company. All the members of this Committee are financially literate. The Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that everyone is properly discharging their responsibilities, and to review the financial statements with the external auditors.

The Committee reports its findings to the Board for consideration when approving the financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the re-appointment of the external auditors.

The financial statements have been audited on behalf of the shareholders by KPMG LLP, the external auditors, in accordance with Canadian generally accepted auditing standards. The external auditors have full and free access to the Audit Committee with respect to their findings concerning the fairness of the financial reporting and the adequacy of internal controls.



**Yves Rosconi**

President and  
Chief Executive Officer



**Luc Tanguay**

Senior Executive Vice President  
and Chief Financial Officer

Montréal, Canada  
January 23, 2009

# AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Theratechnologies Inc. as at November 30, 2008 and 2007 and the consolidated statements of earnings, comprehensive loss, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at November 30, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in dark ink that reads "KPMG LLP". The signature is written in a cursive, slightly slanted style. Below the signature is a horizontal line that starts under the "K" and extends to the right, ending under the "P".

**Chartered Accountants**

Montréal, Canada

January 23, 2009

# CONSOLIDATED BALANCE SHEETS

NOVEMBER 30, 2008 AND 2007

(in thousands of dollars)

	2008	2007
<b>Assets</b>		
Current assets:		
Cash	\$ 133	\$ 2,578
Bonds	10,955	27,466
Accounts receivable	610	451
Tax credits receivable	1,784	1,418
Research supplies	301	2,110
Prepaid expenses	397	414
	<b>14,180</b>	<b>34,437</b>
Bonds	<b>35,249</b>	30,324
Investments in public companies	41	635
Property and equipment (note 4)	1,299	1,722
Other assets (note 5)	3,375	7,472
	<b>\$ 54,144</b>	<b>\$ 74,590</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,198	\$ 8,613
Shareholders' equity:		
Capital stock (note 6)	269,219	238,842
Contributed surplus	5,585	4,807
Accumulated other comprehensive income (loss)	372	(333)
Deficit	(228,230)	(177,339)
	<b>(227,858)</b>	<b>(177,672)</b>
Total shareholders' equity	<b>46,946</b>	<b>65,977</b>
Commitments (note 9)		
Subsequent events (note 15)		
	<b>\$ 54,144</b>	<b>\$ 74,590</b>

See accompanying notes to consolidated financial statements.

On behalf of the Board:



**Paul Pommier**

Director



**Jean-Denis Talon**

Director

# CONSOLIDATED STATEMENTS OF EARNINGS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)	2008	2007
Revenues:		
Royalties, technologies and other (note 7)	\$ 214	\$ 638
Interest	2,427	2,496
	<b>2,641</b>	3,134
Operating costs and expenses:		
Research and development	35,326	31,866
Tax credits	(2,111)	(1,652)
	<b>33,215</b>	30,214
General and administrative	6,185	7,260
Selling and market development	3,811	2,351
Patents, amortization and impairment of other assets (note 5)	5,581	840
Fees associated with the strategic review process and collaboration and licensing agreement (note 15 A)	2,224	—
	<b>51,016</b>	40,665
Operating loss before undernoted item	<b>(48,375)</b>	(37,531)
Realized loss on disposal and impairment of investments in public companies (note 11 B)	(578)	(57)
Net loss	\$ <b>(48,953)</b>	\$ (37,588)
Basic and diluted loss per share (note 6 C)	\$ <b>(0.85)</b>	\$ (0.71)
Weighted average number of common shares outstanding	<b>57,415,468</b>	52,581,559

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars)	2008	2007
Net loss	\$ <b>(48,953)</b>	\$ (37,588)
Unrealized gains (losses) on available-for-sale financial assets	133	(496)
Reclassification adjustment for gains and losses on available-for-sale financial assets (note 11 B)	572	84
Comprehensive loss	\$ <b>(48,248)</b>	\$ (38,000)

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars)	Capital stock		Contributed surplus	Accumulated other comprehensive income		Total
	Number	Dollars		(loss)	Deficit	
Balance, November 30, 2006	46,775,359	\$ 177,552	\$ 3,486	\$ —	\$ (136,563)	\$ 44,475
Changes in accounting policies (note 2 A)	—	—	—	79	—	79
Issuance of share capital (note 6)	6,888,074	57,879	—	—	—	57,879
Share issue costs	—	—	—	—	(3,188)	(3,188)
Exercise of stock options:						
Cash proceeds	867,700	2,392	—	—	—	2,392
Ascribed value	—	1,019	(1,019)	—	—	—
Stock-based compensation	—	—	2,340	—	—	2,340
Net loss	—	—	—	—	(37,588)	(37,588)
Change in unrealized gains and losses on available-for-sale financial assets	—	—	—	(412)	—	(412)
<b>Balance, November 30, 2007</b>	<b>54,531,133</b>	<b>238,842</b>	<b>4,807</b>	<b>(333)</b>	<b>(177,339)</b>	<b>65,977</b>
Issuance of share capital (note 6)	<b>3,564,291</b>	<b>29,899</b>	—	—	—	<b>29,899</b>
Share issue costs	—	—	—	—	(1,938)	(1,938)
Exercise of stock options:						
Cash proceeds	<b>119,666</b>	<b>397</b>	—	—	—	<b>397</b>
Ascribed value	—	<b>81</b>	(81)	—	—	—
Stock-based compensation	—	—	<b>859</b>	—	—	<b>859</b>
Net loss	—	—	—	—	(48,953)	(48,953)
Change in unrealized gains and losses on available-for-sale financial assets	—	—	—	<b>705</b>	—	<b>705</b>
<b>Balance, November 30, 2008</b>	<b>58,215,090</b>	<b>\$ 269,219</b>	<b>\$ 5,585</b>	<b>\$ 372</b>	<b>\$ (228,230)</b>	<b>\$ 46,946</b>

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars)

	2008	2007
Cash flows from operating activities:		
Net loss	\$ (48,953)	\$ (37,588)
Adjustments for:		
Amortization of property and equipment	625	550
Amortization and impairment of other assets	5,398	562
Stock-based compensation	859	2,340
Non-monetary revenues (note 7)	—	(619)
Realized loss on disposal and impairment of investments in public companies	578	57
	<b>(41,493)</b>	<b>(34,698)</b>
Changes in operating assets and liabilities:		
Interest receivable on bonds	405	(364)
Accounts receivable	(134)	(137)
Tax credits receivable	(366)	493
Research supplies	582	368
Prepaid expenses	17	(23)
Accounts payable and accrued liabilities	(1,277)	1,952
	<b>(773)</b>	<b>2,289</b>
	<b>(42,266)</b>	<b>(32,409)</b>
Cash flows from financing activities:		
Share issuance	30,296	60,271
Share issue costs	(1,930)	(3,193)
	<b>28,366</b>	<b>57,078</b>
Cash flows from investing activities:		
Additions to property and equipment	(301)	(547)
Additions to other assets	(146)	(228)
Acquisition of bonds	(17,987)	(41,496)
Disposal of bonds	29,889	19,385
Disposal of investments in public companies	—	779
	<b>11,455</b>	<b>(22,107)</b>
Net change in cash	<b>(2,445)</b>	<b>2,562</b>
Cash, beginning of year	<b>2,578</b>	<b>16</b>
Cash, end of year	<b>\$ 133</b>	<b>\$ 2,578</b>

See note 11 for supplemental cash flow information.

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 1. Organization and business activities

The Company, incorporated under Part 1A of the Québec Companies Act, discovers innovative drug candidates with a view to develop and commercialize them, in order to eventually generate a steady revenue stream. The Company has nevertheless been able to enter into collaboration and licensing agreements that provide funds to finance the development of its products. The Company targets unmet medical needs in financially attractive specialty markets. The Company has concluded a confirmatory Phase 3 clinical trial evaluating tesamorelin, its most advanced compound, in HIV-associated lipodystrophy, a serious metabolic disorder associated with excess abdominal fat. The Company also has other compounds at earlier stages of development.

## 2. New accounting policies

### A. ADOPTION OF NEW ACCOUNTING STANDARDS

Effective with the commencement of its 2008 fiscal year, the Company has adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535, *Capital Disclosures*, CICA Handbook Section 3862, *Financial Instruments – Disclosures*, and CICA Handbook Section 3863, *Financial Instruments – Presentation*. The Sections relate to disclosure and presentation only and did not have an impact on the Company’s financial results (see notes 12 and 13).

Effective with the commencement of its 2007 fiscal year, the Company has adopted the recommendations of the CICA Handbook Section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, and CICA Handbook Section 3865, *Hedges*. On December 1, 2006, the impact of these changes in accounting policies of \$79 is included in the opening balance of accumulated other comprehensive income.

### B. FUTURE ACCOUNTING CHANGES

#### Inventories

In June 2007, the CICA issued Section 3031, *Inventories*, which replaces Section 3030 and harmonizes the Canadian standards related to inventories with International Financial Reporting Standards (“IFRS”). This Section provides changes to the measurement and more extensive guidance on the determination of cost, including allocation of overhead; narrows the permitted cost formulas; requires impairment testing; and expands the disclosure requirements to increase transparency. This Section will apply to the Company’s interim and annual financial statements beginning December 1, 2008. As the Company had no inventories on November 30, 2008, the adoption of this section will have no impact on the Company’s financial statements.

#### Goodwill and intangible assets

In January 2008, the CICA issued Section 3064, *Goodwill and Intangible Assets*, which will replace Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*. The standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition, as well as clarifying the application of the concept of matching revenues and expenses, whether these assets are separately acquired or internally developed. This standard will apply to the Company’s interim and annual financial statements beginning on December 1, 2008 and will be applied retrospectively. The impact of adopting this standard will be to increase the opening deficit at December 1, 2006 by \$861, which is the amount of patent costs related to periods prior to this date, as well as to increase the net loss by \$80 in 2007 and to decrease the net loss by \$342 in 2008.

## 2. New accounting policies (continued)

### B. FUTURE ACCOUNTING CHANGES (CONTINUED)

#### International Financial Reporting Standards

In February 2008, Canada's Accounting Standards Board ("AcSB") confirmed that Canadian GAAP, as used by publicly accountable enterprises, would be fully converged into IFRS, as issued by the International Accounting Standards Board ("IASB"). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. As a result, the Company will be required to report under IFRS for its 2012 interim and annual financial statements. The Company will convert to these new standards according to the timetable set within these new rules. The Company has not determined the impact of adopting the standards on its consolidated financial statements.

## 3. Significant accounting policies

### A. CONSOLIDATION

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

### B. CASH EQUIVALENTS

Cash equivalents are restricted to investments that are readily convertible into cash, having a term to initial maturity not exceeding three months and whose value is not likely to change significantly. As at November 30, 2008 and 2007, there were no cash equivalents.

### C. FINANCIAL ASSETS AND LIABILITIES

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included in the consolidated balance sheet and are measured at fair market value, with the exception of loans and receivables, investments held-to-maturity and other financial liabilities, which are measured at amortized cost. Subsequent measurement and recognition of changes in fair value of financial instruments depend on their initial classification. Held-for-trading financial investments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet or if there is an impairment in fair value of these assets that is other than temporary.

Derivative instruments are recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The Company has classified its bonds and investments in public companies as available-for-sale financial assets and are measured at fair market value. The Company has also classified accounts receivable as loans and receivables and accounts payable and accrued liabilities as other financial liabilities, and they are measured at amortized cost.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 3. Significant accounting policies (continued)

### D. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Amortization is provided using the following methods and annual rates/periods:

Asset	Method	Rate/period
Computer equipment	Declining balance	50%
Laboratory equipment	Declining balance	20%
	and straight-line	5 years
Office equipment and furniture	Declining balance	20%
Leasehold improvements	Straight-line	Term of lease

### E. OTHER ASSETS

Other assets consist namely of intellectual property, patent costs and research supplies.

Intellectual property is amortized over a period of 20 years using the straight-line method.

Patent costs relate to direct costs incurred in connection with securing the patent and do not necessarily reflect their present or future value and the amount ultimately recoverable is dependent upon the successful commercialization of the related products. Amortization of patent costs is calculated over their estimated useful lives, varying from 5 to 17 years, using the straight-line method.

Research supplies are purchased in advance in accordance with regulatory requirements to be used in connection with the Company's clinical trials. Research supplies that are not expected to be used within one year from the date of the balance sheet are classified as long-term.

### F. IMPAIRMENT OF LONG-LIVED ASSETS

The Company reviews its property and equipment and other long-term assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be used is measured by the comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated from the assets. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying value of the asset exceeds the fair value of the asset. The fair value against which the asset is measured may be established based on comparable information or transactions, or any other method of assessment.

### G. REVENUE RECOGNITION

Revenues from research contracts are recognized when services to be provided are rendered and all conditions under the terms of the underlying agreement are met. Revenues subject to the achievement of milestones are recorded only when the specified events have occurred and collectibility is assured.

Upfront payments and initial technology access fees are deferred and recognized as revenue on a systematic basis over the period during which the related products or services are delivered and all obligations are performed.

### **3. Significant accounting policies (continued)**

#### **G. REVENUE RECOGNITION (CONTINUED)**

License fees are recorded when conditions and events under the license agreement have occurred and collectibility is reasonably assured.

Revenues from a collaboration agreement that includes multiple elements are considered to be a revenue arrangement with multiple deliverables. Under this type of arrangement, the identification of separate units of accounting is required and revenue is allocated among the separate units based on their relative fair values. Payments received under the collaboration agreement may include upfront payments, milestone payments, research contracts, license fees and royalties. Revenues for each unit of accounting are recorded as described above.

Interest income is recognized as earned using the effective interest method.

#### **H. RESEARCH AND DEVELOPMENT**

Research expenditures, net of related research tax credits and grants, are charged to earnings in the year in which they are incurred.

Development expenditures, net of tax credits, if any, are capitalized when they meet the appropriate criteria for capitalization in accordance with generally accepted accounting principles. During the years ended November 30, 2008 and 2007, no development expenditures were capitalized.

#### **I. STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS**

The Company records stock-based compensation related to employee and non-employee stock options granted using the fair value based method estimated using the Black-Scholes model. Under this method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period.

#### **J. GOVERNMENT ASSISTANCE**

Government assistance, consisting of research tax credits and grants, is recorded as a reduction of the related expense or cost of the asset acquired. Government grants are recognized when there is reasonable assurance that the Company has met the requirements of the approved grant program. Research tax credits are recorded when there is reasonable assurance that they will be realized.

#### **K. FOREIGN EXCHANGE**

Foreign denominated monetary assets and liabilities are translated in Canadian dollars at the rates of exchange prevailing at the balance sheet dates. Other assets and liabilities are translated at the exchange rates prevailing when the assets were acquired or the liabilities incurred. Revenues and expenses are translated at the average exchange rate prevailing during the year, except for depreciation and amortization which are translated at the same rates as those used in the translation of the corresponding assets. Foreign exchange gains and losses are included in the determination of net earnings or net loss.

#### **L. INCOME TAXES**

The Company uses the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are recognized in the balance sheet to account for the future tax consequences attributable to temporary differences between the respective accounting and taxable value of balance sheet assets and liabilities. As appropriate, a valuation allowance is recognized to decrease the value of tax assets to an amount that is more likely than not to be realized. Future income tax assets and income tax liabilities are measured using income tax rates that are enacted or substantively enacted when the asset is realized or the liability is settled. The effect of changes in income tax rates is recognized in the year during which these rates change.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 3. Significant accounting policies (continued)

### M. EARNINGS PER SHARE

The earnings per share are determined using the weighted average number of outstanding shares during the year.

The treasury stock method is used for the computation of the diluted earnings per share. Under this method, a number of additional shares, if they are dilutive, are calculated assuming that the outstanding stock options and warrants are exercised, and that the proceeds from the transactions are used to purchase common shares at the average market price during the period.

### N. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates include estimating the useful lives and recoverability of long-lived assets, including property and equipment and other assets, estimating accruals for clinical trial expenses, estimating stock-based compensation and revenue, as well as assessing the recoverability of research tax credits and grants, investments and future income taxes. Reported amounts and note disclosure reflect the overall economic conditions that are most likely to occur and anticipated measures to be taken by management. Actual results could differ from those estimates.

## 4. Property and equipment

	2008		
	Cost	Accumulated amortization	Net book value
Computer equipment	\$ 682	\$ 500	\$ 182
Laboratory equipment	1,824	1,427	397
Office equipment and furniture	1,015	700	315
Leasehold improvements	1,846	1,441	405
	<b>\$ 5,367</b>	<b>\$ 4,068</b>	<b>\$ 1,299</b>

  

	2007		
	Cost	Accumulated amortization	Net book value
Computer equipment	\$ 645	\$ 415	\$ 230
Laboratory equipment	1,756	1,314	442
Office equipment and furniture	989	624	365
Leasehold improvements	1,840	1,155	685
	<b>\$ 5,230</b>	<b>\$ 3,508</b>	<b>\$ 1,722</b>

## 5. Other assets

	<b>2008</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Intellectual property	\$ 7,670	\$ 7,670	\$ —
Patent costs	2,092	1,493	599
Research supplies	2,751	—	2,751
Other assets	25	—	25
	<b>\$ 12,538</b>	<b>\$ 9,163</b>	<b>\$ 3,375</b>

In 2008, the Company wrote off \$287 of patent costs following a review by management of the development strategy and choice of a specific molecule for the related product.

The Company also conducted an impairment test on the intellectual property included in “Other assets” following a review of the development strategy by management for new products. As a consequence, the Company wrote off the carrying amount of this intellectual property. The write-off of \$4,571 is included in “Patents, amortization and impairment of other assets” in the consolidated statements of earnings.

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Intellectual property	\$ 7,670	\$ 2,713	\$ 4,957
Patent costs	1,993	1,052	941
Research supplies	1,524	—	1,524
Other assets	50	—	50
	<b>\$ 11,237</b>	<b>\$ 3,765</b>	<b>\$ 7,472</b>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 6. Capital stock

	2008	2007
Authorized in unlimited number and without par value:		
Common shares		
Preferred shares issuable in one or more series		
Issued:		
58,215,090 common shares (2007 - 54,531,133)	\$ 269,219	\$ 238,842

### 2008

On February 13, 2008, the Company completed a public offering for the sale and issue of 3,500,000 common shares for cash proceeds of \$29,750. The issuance costs amounted to \$1,938.

In 2008, the Company received subscriptions in the amount of \$149 for the issuance of 64,291 common shares in connection with its share purchase plan.

All shares were issued for a cash consideration.

### 2007

In 2007, the Company concluded a public offering for the sale and issuance of 6,875,000 common shares, including the over-allotment option, for proceeds of \$57,750. The issuance costs amounted to \$3,188.

In 2007, the Company also received subscriptions in the amount of \$129 for the issuance of 13,074 common shares in connection with its share purchase plan.

All shares were issued for a cash consideration.

### A. STOCK OPTION PLAN

The Company has established a stock option plan under which it can grant to its directors, officers, employees, researchers and consultants non-transferable options for the purchase of common shares. The exercise date of an option may not be later than 10 years after the date it is granted. A maximum number of 5,000,000 options can be granted under the plan. Generally, the options vest at the date of the grant or over a period of 0 to 5 years. On November 30, 2008, 1,748,834 additional options could be granted by the Company.

## 6. Capital stock (continued)

### A. STOCK OPTION PLAN (CONTINUED)

Changes in the number of options outstanding during the past two fiscal years were as follows:

	Options	Weighted average exercise price per share
Options as at November 30, 2006	2,551,000	\$ 4.26
Granted	608,500	9.41
Exercised	(867,700)	2.76
Cancelled and expired	(84,167)	2.80
Options as at November 30, 2007	2,207,633	6.32
Granted	111,000	7.98
Exercised	(119,666)	3.32
Cancelled	(37,167)	9.57
Options as at November 30, 2008	2,161,800	\$ 6.52

The following table provides stock option information as at November 30, 2008:

Price range	Options outstanding		Exercisable options		
	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price	Number of exercisable options	Weighted average exercise price
\$ 1.20 - \$ 2.00	640,008	7.01	\$ 1.60	535,000	\$ 1.65
2.01 - 2.75	141,459	5.85	2.59	141,459	2.59
2.76 - 3.75	50,000	6.17	3.60	40,000	3.67
3.76 - 4.60	—	—	—	—	—
4.61 - 6.00	83,500	1.64	5.24	83,500	5.24
6.01 - 9.00	625,333	6.85	8.18	519,666	8.16
9.01 - 13.50	570,000	5.30	10.84	413,331	10.69
13.51 - 15.30	51,500	2.28	15.15	51,500	15.15
	2,161,800	6.10	\$ 6.52	1,784,456	\$ 6.32

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 6. Capital stock (continued)

### B. STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

The estimated fair value of the options granted was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2008	2007
Risk-free interest rate	3.36%	4.22%
Volatility	70.4%	68.7%
Average option life in years	6	6
Dividend yield	nil	nil

The risk-free interest rate is based on the implied yield on a Canadian Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The volatility is based solely on historical volatility equal to the expected term of the option. The average life of the options is estimated considering the vesting period, the term of the option and the length of time similar grants have remained outstanding in the past. 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.

The following table summarizes the weighted average fair value of stock options granted during the years ended November 30, 2008 and 2007:

	Number of options	Weighted average grant-date fair value
2008	111,000	\$ 5.16
2007	608,500	6.10

The Black-Scholes model, used by the Company to calculate option values, as well as other accepted option valuation models, was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differs from the Company's stock option awards. These models also require four highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values.

## 6. Capital stock (continued)

### C. DILUTED LOSS PER SHARE

Diluted loss per share was not presented as the effect of options would have been anti-dilutive. Furthermore, 641,500 options (2007 — 251,500) could have an effect on the calculation in the future, since their exercise prices were higher than the average market price during 2008 and 2007.

## 7. Royalties, technologies and other

On September 26, 2007, the Company signed a licensing agreement whereby OctoPlus N.V. (“OctoPlus”) acquired the exclusive worldwide rights for the development and commercialization of its *Glucagon-like Peptide-1* (“GLP-1”) program: a portfolio of analogues for the treatment of diabetes and other potential indications. OctoPlus’s proprietary drug delivery technology in the area of controlled release will be combined with one of the Company’s GLP-1 compounds to produce a product candidate that may reduce the required dosing frequency in diabetes therapy.

The Company received 200,000 OctoPlus stock options upon signature of the agreement. In addition, pursuant to the terms of the agreement, OctoPlus will make milestone payments to the Company of up to €36 million (approximately CAD\$57 million), based on development, clinical phases and commercialization. Royalties on the annual net sales of any products developed and commercialized under the agreement could also be paid to the Company. OctoPlus will be responsible for all future development costs for GLP-1 portfolio compounds.

As the Company has no service obligations under the agreement, the fair value of \$619 of the options received upon signature of the agreement has been recorded as revenue by the Company. The options have a contractual life of 10 years and are exercisable at the average market price of OctoPlus’ shares for the 10 days preceding the date of the agreement. The options granted by OctoPlus have been classified as available-for-sale financial assets and are measured at the fair market value. The estimated fair value of the options granted was estimated using the Black-Scholes option pricing model with the following assumptions:

	November 30, 2008	November 30, 2007	September 26, 2007
Risk-free interest rate	2.44%	3.8%	4.29%
Volatility	44.23%	41.91%	38.75%
Option life in years	8.8	9.8	10
Dividend yield	nil	nil	nil

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 8. Future income taxes

Details of the components of income taxes are as follows:

	2008	2007
Net loss before income taxes	\$ (48,953)	\$ (37,588)
Basic income tax rate	31.0%	32.0%
Computed income tax provision	(15,175)	(12,028)
Adjustments to income tax provision resulting from:		
Impact of decrease in federal tax rates:		
Decrease in value of future tax assets	5,910	926
Change in valuation allowance	(5,910)	(926)
Unrecorded potential tax benefit of current year losses and other deductions	17,307	10,075
Non-deductible items and others	(2,132)	1,953
	\$ —	\$ —

The tax incidence of temporary differences resulting in significant portions of future income tax assets is as follows:

	2008	2007
Future income tax assets:		
Losses carried forward	\$ 16,045	\$ 11,434
Unused research and development expenses	26,591	30,976
Property and equipment	544	709
Share issue costs	1,174	1,127
Intellectual property and patent fees	16,248	4,854
Available deductions and other	4,183	5,621
	64,785	54,721
Future income tax liabilities:		
Intellectual property	—	(1,333)
	64,785	53,388
Less valuation allowance	(64,785)	(53,388)
Net future income tax asset	\$ —	\$ —

In estimating the realization of future income tax assets, management considers whether a portion or all future tax assets are more likely than not to be realized. Realization of future tax assets is subject to the generation of future taxable income.

## 8. Future income taxes (continued)

As at November 30, 2008, the Company had available the following deductions, losses and credits:

	Federal	Provincial
Research and development expenses, without time limitation	\$ 95,467	\$ 103,118
Losses carried forward, until:		
2014	\$ 9,603	\$ —
2015	275	—
2027	7,638	7,628
2028	46,520	46,475
	\$ 64,036	\$ 54,103
Unused tax credits expiring in:		
2013	\$ 559	
2014	1,597	
2015	1,863	
2026	2,178	
2027	3,000	
2028	3,328	
	\$ 12,525	
	Federal	Provincial
Share issue costs	\$ 4,047	\$ 4,047
Excess of tax value of intellectual property and patent fees over carrying value	60,414	60,390
Excess of tax value of property and equipment over carrying value	2,616	1,280

## 9. Commitments

### A. RENTAL OF PREMISES

The Company rents premises under operating leases expiring in April 2010. The minimum payments required under the terms of the lease are as follows:

2009	\$ 816
2010	340
	\$ 1,156

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

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## 9. Commitments (continued)

### A. RENTAL OF PREMISES (CONTINUED)

The Company has issued an irrevocable letter of credit amounting to \$505, along with a first rank movable mortgage in the amount of \$1,150 covering the Company's tangible assets located in the rented premises. However, this mortgage can be subordinated to those of lending institutions. The lease includes progressive reduction clauses with respect to the amount of the letter of credit beginning in 2004, as well as an option for the purchase of the building and land and a renewal option.

As at November 30, 2008 and 2007, the Company has recorded no liability with respect to this guarantee, as the Company does not expect to make any payments for the aforementioned item. Management has determined that the fair value of the non-contingent obligations requiring performance under the guarantee in the event that specified triggering events or conditions occur approximates the cost of obtaining the standby letters of credit.

### B. CREDIT FACILITY

The Company has a credit facility available in the amount of \$1,800, bearing interest at prime plus 0.5% and secured by bonds. Under the credit facility, the market value of investments held must always be equivalent to 150% of advances. If the market value falls below \$7,000, the Company will agree to give the bank a first rank movable hypothec of \$1,850 on securities judged satisfactory by the bank.

As at November 30, 2008 and 2007, with the exception of the letter of credit mentioned in (A) above, the credit facility available to the Company was not utilized.

## 10. Licenses

In addition to the exclusively held products, the Company has certain exclusive licenses to market or commercialize intellectual property from research activities performed by certain research institutions. Under these licenses, the Company is committed to pay royalties on the net sales of the products commercialized by the Company, or, if applicable, on the amounts received from sub-license, subject to the application of the clauses of such agreements.

## 11. Supplemental information

### A. STATEMENT OF CASH FLOWS

The following transactions were conducted by the Company and did not impact cash flows:

	2008	2007
Additions to property and equipment included in accounts payable and accrued liabilities	\$ 48	\$ 147
Additions to other assets included in accounts payable and accrued liabilities	17	64
Share issue costs included in accounts payable and accrued liabilities	8	—

## 11. Supplemental information (continued)

- B.** In 2008, the Company has reclassified in net earning \$572 of realized losses on available-for-sale financial assets previously recorded in accumulated other comprehensive income. The realized loss includes impairment charge of \$578 related to a decline in value that is other than temporary for stock options held in OctoPlus.

In 2007, the Company has reclassified in net earnings \$84 of realized losses on available-for-sale financial assets previously recorded in accumulated other comprehensive income. The realized loss includes a gain of \$537 on disposal of the investment in Sonomed inc. (formerly Andromed Inc.). In 2007, the Company received \$628 as a result of the redemption of the Sonomed shares held by the Company. In 2007, the Company also disposed of its remaining shares in Thallion Pharmaceutical Inc. (formerly Ecopia BioSciences Inc.) for \$151 and realized a loss of \$594.

On November 30, 2008, the accumulated other comprehensive income was composed of unrealized gains on available-for-sale financial assets of \$372 (loss of \$333 on November 30, 2007).

- C.** The Company received tax credits of \$1,746 in 2008 (2007 - \$2,144).
- D.** The following items were included in the determination of the Company's net loss:

	2008	2007
Amortization of property and equipment	\$ 625	\$ 550
Amortization and impairment of other assets (note 5)	5,398	562

## 12. Capital disclosures

The Company's objective in managing capital is to ensure a sufficient liquidity position to finance its research and development activities, general and administrative expenses, working capital and overall capital expenditures, and patents. The Company makes every attempt to manage its liquidity to minimize shareholder dilution.

To fund its activities, the Company has followed an approach that relies almost exclusively on the issuance of common equity, as well as proceeds and royalties from technologies following the closing of the transaction disclosed in note 15. Since inception, the Company has financed its liquidity needs primarily through public offerings of common shares and private placements. When possible, the Company tries to optimize its liquidity position through non-dilutive sources, including investment tax credits, grants, interest income as well as proceeds and royalties from technologies.

The Company's policy is to maintain a minimum level of debt. The Company has a line of credit of \$1,800 for its short-term financing needs. As at November 30, 2008, this line of credit has not been used.

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 12. Capital disclosures (continued)

At November 30, 2008, cash and bonds amounted to \$46,337 and tax credits receivable amounted to \$1,784, for a total of \$48,121. Furthermore, after November 30, 2008, the Company received a gross amount of \$36,951 following the closing of the transaction disclosed in note 15. The Company believes that its cash position will be sufficient to finance its operations and capital needs for the next year.

The Company's general policy on dividends is to retain cash to keep funds available to finance the Company's growth. However, the Board of Directors may, from time to time, choose to declare a dividend in assets if warranted by circumstances.

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

## 13. Financial risk management

This note 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.

### A. CREDIT RISK

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company regularly monitors credit risk exposure and takes steps to mitigate the likelihood of this exposure resulting in losses.

Financial instruments other than cash that potentially subject the Company to significant credit risk consist principally of bonds. The Company invests its available cash in fixed income instruments from governmental, para-governmental and municipal bonds (\$43,795 as at November 30, 2008) as well as from corporations with high credit ratings (\$2,409 as at November 30, 2008). As at November 30, 2008, the Company was not exposed to any credit risk over the carrying amount of the bonds.

### B. 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 and financial leverage, as outlined in note 12. It also manages liquidity risk by continuously monitoring actual and projected cash flows. The Board of Directors and/or the audit committee reviews and approves the Company's operating and capital budgets, as well as any material transactions out of the ordinary course of business.

The Company has adopted an investment policy in respect of the safety and preservation of its capital to ensure the Company's liquidity needs are met.

The instruments are selected with regard to the expected timing of expenditures and prevailing interest rates. Bonds mature during the following fiscal years: \$10,955 in 2009, \$14,367 in 2010, \$14,776 in 2011 and \$6,106 in 2012.

## 13. Financial risk management (continued)

### B. LIQUIDITY RISK (CONTINUED)

The following are the contractual maturities of financial liabilities, as well as the payments required under the terms of the operating lease, as at November 30, 2008:

	Total	Carrying amount	Less than 1 year	1 to 3 years
Accounts payable and accrued liabilities	\$ 7,198	\$ 7,198	\$ 7,198	\$ —
Operating lease	1,156	—	816	340
	\$ 8,354	\$ 7,198	\$ 8,014	\$ 340

### C. FOREIGN CURRENCY RISK

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates and the degree of volatility of those rates. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than the Canadian dollar, primarily expenses for research and development incurred in US dollars, euros and pounds ("GBP"). The Company does not use derivative financial instruments to reduce its foreign exchange exposure.

The Company manages foreign exchange risk by maintaining US cash on hand to support US forecasted cash outflows for a maximum 12-month period. The Company does not currently view its exposure to the euro and GBP as a significant foreign exchange risk due to the limited volume of transactions conducted by the Company in these currencies.

The Company believes that the results of operations and cash flows would be affected by a sudden change in foreign exchange rates, but would not impair or enhance its ability to pay its US dollar denominated obligations.

The following table provides significant items exposed to foreign exchange as at November 30, 2008:

	November 30, 2008		
	US\$	EURO	GBP
Cash	1	—	—
Accounts receivable	—	—	—
Accounts payable and accrued liabilities	(2,589)	(159)	(348)
Balance sheet's elements exposed to foreign currency risk	(2,588)	(159)	(348)

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2008 AND 2007

(in thousands of dollars, except per share amounts)

## 13. Financial risk management (continued)

### C. FOREIGN CURRENCY RISK (CONTINUED)

The following exchange rates applied during the year ended November 30, 2008:

	Average rate November 30, 2008	Reporting date rate November 30, 2008
US\$ - CAD\$	1.0479	1.2370
EURO - CAD\$	1.5440	1.5711
GBP - CAD\$	1.9767	1.9060

Based on the Company's foreign currency exposures noted above, varying the above foreign exchange rates to reflect a 5% strengthening of the Canadian dollar would have decreased the net loss as follows, assuming that all other variables remained constant:

(in thousands of Canadian dollars)	US\$	EURO	GBP
Decrease in net loss	129	8	17

An assumed 5% weakening of the Canadian dollar would have had an equal but opposite effect on the foreign currency amounts shown above, on the basis that all other variables remain constant.

### D. 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 interest rates.

Short-term bonds of the Company are invested at fixed interest rates and mature in the short-term. Long-term bonds are also instruments that bear interest at fixed rates. The risk that the Company will realize a loss as a result of a decline in the fair value of its bonds is limited because these investments, although they are available for sale, are generally held to maturity. The unrealized gains or losses on bonds are recorded in the accumulated other comprehensive income (loss).

Cash bears interest at a variable rate. Accounts receivable, accounts payable and accrued liabilities bear no interest.

Based on the value of variable interest-bearing cash during the year ended November 30, 2008, an assumed 0.5% point increase in interest rates during such period would have decreased cash flows from operating activities the net loss by \$31, with an equal but opposite effect for an assumed 0.5% point decrease in interest rates.

## 14. Financial instruments

### A. CARRYING VALUE AND FAIR VALUE

The Company has determined that the carrying values of its short-term financial assets and liabilities, including cash, accounts receivable, as well as accounts payable and accrued liabilities, approximate their fair value because of the relatively short period to maturity of the instruments.

Bonds and investments in public companies are stated at estimated fair value, determined by prices quoted on active markets.

### B. INTEREST INCOME AND EXPENSES

Interest income consists of interest earned on cash and bonds.

### C. LOSS ON EXCHANGE

General and administrative expenses include a loss on foreign exchange of \$247 (loss of \$598 in 2007) for the year ended November 30, 2008.

## 15. Subsequent events

- A. On October 28, 2008, the Company entered into a collaboration and licensing agreement with EMD Serono, Inc., an affiliate of Merck KGaA, regarding the exclusive commercialization rights of tesamorelin in the United States for the treatment of excess abdominal fat in HIV patients with lipodystrophy (the "Initial Product"). Theratechnologies retains all tesamorelin commercialization rights outside of the US.

Under the terms of the agreement, the Company is responsible for the development of the Initial Product up to obtaining marketing approval in the United States. The Company is also responsible for product production and for the development of a new formulation of the Initial Product. EMD Serono is responsible for conducting product commercialization activities.

At the closing of the agreement, on December 15, 2008, the Company received US\$30,000 (CAD\$36,951) which includes an initial payment of US\$22,000 (CAD\$27,097) and US\$8,000 (CAD\$9,854) as a subscription for common shares in the Company by Merck KGaA at a price of US\$3.67 (CAD\$4.52) per share. The Company may receive up to US\$215,000 (CAD\$265,000), which amount includes the initial payment of US\$22,000, the equity investment of US\$8,000, as well as payments based on the achievement of certain development, regulatory and sales milestones. The Company will also be entitled to receive escalating royalties on annual net sales of tesamorelin in the US.

The Company may conduct research and development for additional indications. EMD Serono will have the option to commercialize additional indications for tesamorelin in the US. If it exercises this option, EMD Serono will pay half of the development costs related to such additional indications. In such cases, the Company will also have the right, subject to EMD Serono's agreement, to participate in the promotion of the additional indications.

The fees associated with the strategic review process and the conclusion of the collaboration and licensing agreement with EMD Serono amounted to \$2,224 in 2008 and transaction costs payable at closing are estimated at \$4,260 for 2009.

- B. On December 18, 2008, the Company granted 590,500 stock options at an exercise price of \$1.80 per share in connection with its compensation program.