



## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED MAY 31, 2010

The following Management's Discussion and Analysis ("MD&A") provides Management's point of view on the financial position and the results of operations of Theratechnologies Inc. ("Theratechnologies" or the "Company"), for the three-month and six-month periods ended May 31, 2010, as compared to the three-month and six-month periods ended May 31, 2009. This view contains certain factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A should be read in conjunction with the unaudited interim consolidated financial statements of the Company and the notes thereto as at May 31, 2010, as well as the MD&A and audited consolidated financial statements including the related notes thereto as at November 30, 2009. Unless specified otherwise, all amounts are in Canadian dollars.

### **Financial Overview**

Theratechnologies (TSX: TH) is a Canadian biopharmaceutical company that discovers and develops innovative therapeutic products, with an emphasis on peptides, for commercialization. The Company targets unmet medical needs in financially attractive specialty markets where it can retain all or some of the commercial rights to its products. Its most advanced compound, tesamorelin, is an analogue of the human growth hormone releasing factor.

The Company's growth strategy is centered upon the development of tesamorelin. In late 2008, Theratechnologies entered into a collaboration and licensing agreement with EMD Serono, Inc. ("EMD Serono") (an affiliate of Merck KGaA, Darmstadt, Germany), for the exclusive commercialization rights to tesamorelin for the treatment of excess abdominal fat in HIV-infected patients with lipodystrophy in the United States. The principal strategic objective of Theratechnologies is to obtain regulatory approval for tesamorelin in this indication and good progress was made in the second quarter by participating in the U.S. Food and Drug Administration ("FDA" or the "Agency") Endocrinologic and Metabolic Drugs Advisory Committee. On May 27, 2010, the Committee recommended by a 16 to 0 unanimous vote that tesamorelin be granted marketing approval by the FDA for this treatment. Although advisory committees provide their recommendations to the FDA, the final decisions on marketing approvals are made by the Agency. The FDA has indicated that the action goal date, which is the target date for the FDA to complete its review of the tesamorelin New Drug Application ("NDA"), will be July 27, 2010. If tesamorelin is approved, the Company expects to receive regulatory milestone payments, royalties and additional milestone payments from sales of tesamorelin by EMD Serono in the U.S.

In addition, Theratechnologies has begun building inventory in preparation for the launch of tesamorelin in the U.S., in the event of FDA approval. In the coming months, the Company will continue building inventory.

In the event of approval of tesamorelin, the anticipated 2010 adjusted burn rate of \$24,000,000 could be increased by 5 to 10%. Principal components of the potential increase in spending include the qualification of back-up suppliers for tesamorelin and the drug's fill and finish operation, as well as preparations for the filing of a New Drug Submission in Canada. Most of these costs would be associated to projects that are non-repetitive in nature and would be related to the acceleration of activities in the current business plan.

### **Revenues**

Consolidated revenues for the three-month period ended May 31, 2010, amounted to \$2,226,000, compared to \$2,317,000 for 2009. The decreased revenues for the second quarter of 2010 are related to lower interest revenues due to a lower cash position and a lower interest rate on investments compared to the same period in 2009. For the six-month period ended May 31, 2010, consolidated revenues were \$4,521,000, compared to \$4,326,000 for the same period in 2009. The

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increased revenues for the six-month period in 2010 are related to a longer amortization period (6 months in 2010 versus 5.5 months in 2009) for the initial payment received within the collaboration and licensing agreement with EMD Serono.

The initial payment received upon the closing of the agreement with EMD Serono of \$27,097,000 has been deferred and is being amortized over its estimated service period on a straight-line basis. This period may be modified in the future based on additional information that the Company may receive. For the three-month period ended May 31, 2010, an amount of \$1,711,000 (\$1,711,000 for the same period in 2009) was recognized as revenue related to this transaction, while an amount of \$3,423,000 was recognized as revenue for the six-month period related to this transaction (\$3,137,000 for the same period in 2009). At May 31, 2010, the deferred revenues related to this transaction recorded on the balance sheet amounted to \$17,114,000.

### **R&D Activities**

Research and development ("R&D") expenses, before tax credits, totalled \$4,259,000 for the second quarter of 2010, compared to \$5,696,000 in 2009. For the six-month period ended May 31, 2010, R&D expenses were \$8,368,000, compared to \$12,011,000 for the same period in 2009, representing a decrease of 30.3%. The R&D expenses incurred in the second quarter of 2010 are mainly related to regulatory activities connected with the preparation for the FDA Advisory Committee meeting, whereas the expenses incurred in the second quarter of 2009 were principally related to the end of the Phase 3 clinical trials evaluating tesamorelin in HIV-associated lipodystrophy and the preparation of the NDA which was submitted to the FDA in May 2009. This explains the significant reduction in R&D expenses in accordance with the Company's plans.

### **Other Expenses**

For the second quarter of 2010, general and administrative expenses amounted to \$2,057,000, compared to \$1,857,000 for the same period in 2009. For the six-month period ended May 31, 2010, general and administrative expenses amounted to \$3,858,000, compared to \$4,178,000 for the same period in 2009. The increase in the second quarter of 2010 is due to costs associated with heightened communication activities related to the FDA Advisory Committee meeting as well as increases in other administrative expenses, partially offset by a reduction in the foreign exchange loss. The higher expenses in the six-month period of the prior year were primarily due to costs associated with revising the Company's business plan and an increase in foreign exchange loss for the year.

Selling and market development expenses amounted to \$764,000 for the second quarter of 2010, compared to \$540,000 for the same period in 2009. For the six-month period ended May 31, 2010, selling and market development expenses amounted to \$1,380,000, compared to \$1,021,000 for the same period in 2009. The increase in the selling and market development expenses are principally due to business development and market research expenses for territories outside the United States. These expenses also include activities associated with the management of the agreement with EMD Serono.

### **Net Results**

Taking into account the revenues and expenses described above, the Company recorded a second quarter net loss of \$4,823,000 (\$0.08 per share), compared to a net loss of \$5,430,000 (\$0.09 per share) for the same period in 2009. For the six-month period ended May 31, 2010, the net loss was \$9,090,000 (\$0.15 per share), compared to a net loss of \$16,184,000 (\$0.27 per share) for the same period in 2009.

The net loss in the second quarter of 2010 includes a revenue of \$1,711,000 related to the agreement with EMD Serono. Excluding this item, the adjusted net loss amounted to \$6,534,000 in 2010, a decrease of 8.5% compared to the same period in 2009. For the six-month period, the net loss included revenue and fees related to the agreement with EMD Serono. Excluding those items, the adjusted net loss amounted to \$12,513,000, compared to \$15,052,000 for the same period in 2009, representing a decrease of 16.9%.

## Financial Position

At May 31, 2010, liquidities, which include cash and bonds, amounted to \$49,048,000, and tax credits receivable amounted to \$2,002,000, for a total of \$51,050,000.

Taking into account the revenues and expenses described above, for the three-month period ended May 31, 2010, the burn rate from operating activities, excluding changes in operating assets and liabilities, was \$4,387,000, compared to \$4,988,000 in 2009. Excluding the revenue and fees related to the agreement with EMD Serono, the adjusted burn rate from operating activities, excluding changes in operating assets and liabilities, was \$6,098,000 for the quarter ended May 31, 2010, compared to \$6,699,000 for the second quarter of 2009, a decrease of 9%.

Taking into account the revenues and expenses described above, for the six-month period ending May 31, 2010, the burn rate from operating activities, excluding changes in operating assets and liabilities, was \$8,248,000, compared to \$15,400,000 for the same period in 2009. Excluding the revenue and fees associated with the agreement with EMD Serono, the adjusted burn rate from operating activities, excluding changes in operating assets and liabilities, was \$11,671,000, compared to \$14,268,000 for the corresponding period in 2009, representing a decrease of 18.2%.

## Quarterly Financial Information

The selected financial information provided below is derived from the Company's unaudited quarterly financial statements for each of the last eight quarters. This information has been restated following the adoption of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, *Goodwill and Intangible Assets*.

(in thousands of Canadian dollars, except per share amounts)

	2010				2009			2008
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenues	\$ 2,226	\$ 2,295	\$ 2,246	\$ 13,148	\$ 2,317	\$ 2,009	\$ 616	\$ 710
Net (loss) earnings	\$ (4,823)	\$ (4,267)	\$ (4,698)	\$ 5,824	\$ (5,430)	\$ (10,754)	\$ (15,145)	\$ (11,220)
Basic and diluted (loss) earnings per share	\$ (0.08)	\$ (0.07)	\$ (0.08)	\$ 0.10	\$ (0.09)	\$ (0.18)	\$ (0.26)	\$ (0.19)

As described above, the increased revenues in 2010 and 2009 are related to the amortization of the initial payment received at the closing of the agreement with EMD Serono, as well as the milestone payment of \$10,884,000 recorded in August 2009. The increase in the fourth quarter net loss in 2008 is due to impairment charges for intellectual property.

## Non-GAAP Measures

The Company uses measures that do not conform to GAAP to assess its operating performance. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings and are unlikely to be comparable to similar measures used by other companies. Accordingly, these measures should not be considered in isolation. The Company uses non-GAAP measures such as adjusted net loss and the adjusted burn rate from operating activities before changes in operating assets and liabilities, to measure its performance from one period to the next without including changes caused by certain items that could potentially distort the analysis of trends in its operating performance, and because such measures provide meaningful information on the Company's financial condition and operating results.

## Definition and Reconciliation of Non-GAAP Measures

In order to measure performance from one period to another, without accounting for changes related to the impact of revenues and fees associated with the collaboration and license agreement with EMD Serono, management uses adjusted net loss and adjusted burn rate from operating activities before changes in operating assets and liabilities. These items are excluded because they affect the comparability of the financial results and could potentially distort the analysis of trends in the Company's operating performance. The exclusion of these items does not necessarily indicate that they are non-recurring.

(Thousands of dollars)

	May 31st (3 months)		May 31st (6 months)	
	2010	2009	2010	2009
<b>Adjusted net loss</b>				
Net loss, per the financial statements	\$ (4,823)	\$ (5,430)	\$ (9,090)	\$ (16,184)
Adjustments:				
Revenue associated with a collaboration and license agreement (note 6 to the consolidated financial statements)	(1,711)	(1,711)	(3,423)	(3,137)
Fees associated with collaboration and license agreement	-	-	-	4,269
Adjusted net loss	\$ (6,534)	\$ (7,141)	\$ (12,513)	\$ (15,052)
<b>Adjusted burn rate before changes in operating assets and liabilities</b>				
Burn rate before changes in operating assets and liabilities, per the financial statements	\$ (4,387)	\$ (4,988)	\$ (8,248)	\$ (15,400)
Adjustments:				
Revenue associated with a collaboration and license agreement (note 6 to the consolidated financial statements)	(1,711)	(1,711)	(3,423)	(3,137)
Fees associated with collaboration and license agreement	-	-	-	4,269
Adjusted burn rate before changes in operating assets and liabilities	\$ (6,098)	\$ (6,699)	\$ (11,671)	\$ (14,268)

## New Accounting Policies

In February 2008, the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada, as used by public companies, will converge with International Financial Reporting Standards ("IFRS"). The Company's changeover from current Canadian GAAP to IFRS applies to the fiscal year beginning December 1, 2011 (the "Changeover" date), when the Company will report financial information for the first quarter ending February 29, 2012, and that of the comparative period in accordance with IFRS.

IFRS uses a conceptual framework similar to Canadian GAAP, but presents significant differences in recognition, measurement and the disclosure of information. In the period leading up to the conversion, the AcSB will continue to issue accounting standards that are better aligned with IFRS, thus mitigating the impact of conversion to IFRS. Further, the International Accounting Standards Board ("IASB") will continue to issue new, or amend existing accounting standards during the conversion period. It will therefore be impossible to determine the final and complete impact on the Company's consolidated financial statements of applying IFRS prior to knowing all applicable IFRS standards at the Changeover date.

### Conversion Plan

The Company's IFRS convergence project includes four steps: diagnostic and planning, detailed analysis, design, and implementation.

*Phase One: Diagnostic Phase* – This phase involves establishing a transition plan to IFRS and the initial identification of differences between Canadian GAAP and IFRS.

*Phase Two: Detailed Analysis* – This phase involves a comprehensive assessment of the differences between the Company's current accounting policies and the requirements of IFRS in order to evaluate the impact on the Company. In addition, the detailed analysis will identify training requirements, and determine eventual changes to business processes and information systems.

*Phase Three: Design* – This phase consists of an analysis of the available accounting options under IFRS, notably the exceptions, exemptions and actual choices available for the transition and the preparation of draft IFRS financial statements and the accompanying notes. In addition, it is during this phase that changes to the business processes and the information systems are designed.

*Phase Four: Implementation* – This phase involves implementing changes to systems, business processes and internal controls, determining the opening IFRS transition balance sheet and the impact on taxation, parallel accounting under Canadian GAAP and IFRS and preparing detailed reconciliations between Canadian GAAP and IFRS financial statements.

### Conversion Progress

The Company has completed the Diagnostic Phase in which the preliminary plan for the transition from current GAAP to IFRS was completed and a team to implement the project was formed. The team, overseen by the senior financial officers, provides governance, management and support for the entire project and meets with the members of the Audit Committee quarterly in order to provide an update on the progress achieved and to discuss important issues. A similar exercise is also performed with the external auditors.

The Company has now begun the Detailed Analysis Phase which entails a comprehensive analysis of the IFRS changes identified in the Diagnostic Phase and the exemptions concerning the transition to IFRS as foreseen in IFRS 1.

### Potential Impact on the Company

According to the comparative analysis of the current IFRS with Canadian GAAP, upon which the Company's accounting practices are now based, the principal changes could affect the following accounting practices:

- Presentation of financial statements
- Foreign exchange conversion
- Stock-based payment
- Impairment of assets

This list is not comprehensive and only lists the principal differences in accounting practices that, according to the Company's current analysis, will flow from the conversion to IFRS.

However, analysis of the changes is still in progress and certain decisions remain to be made with respect to available choices of accounting practices. Furthermore, the organizations overseeing Canadian GAAP and IFRS have significant ongoing projects that could affect the ultimate differences between Canadian GAAP and IFRS and their impact on the Company's consolidated financial statements in future years. The areas of differences should be based on existing Canadian GAAP and the IFRS that will be in effect on November 30, 2012. At this point in time, the Company

is not able to reliably quantify the full impact of these differences on its consolidated financial statements.

The Company continues to evaluate the impact of transitioning to IFRS on the communication of its financial results. At present, the impact of this transition on the Company's financial position and future operating results can neither be determined nor estimated in a reasonable fashion.

#### **Outstanding Share Data**

On July 6, 2010, the number of shares issued and outstanding was 60,497,934, while outstanding options granted under the stock option plan were 2,897,472.

#### **Contractual Obligations**

There were no material changes in contractual obligations during the first six months of the year, other than in the ordinary course of business.

#### **Economic and Industry Factors**

Economic and industry factors were substantially unchanged from those reported in the Company's 2009 Annual Report.

#### **Forward-Looking Information**

This MD&A for the second quarter of 2010 contains certain statements that are considered "forward-looking information" within the meaning of applicable securities legislation. This forward-looking information includes, but is not limited to, information regarding the approval of tesamorelin for the treatment of excess abdominal fat in HIV-infected patients with lipodystrophy by the FDA, the receipt of milestone payments and/or royalties under the agreement entered into with EMD Serono, the filing of a New Drug Submission in Canada, the potential increase in the adjusted burn rate, and the completion of a conversion plan to IFRS. Furthermore, the words "will", "may", "could", "should", "outlook", "believe", "plan", "envisage", "anticipate", "expect" and "estimate", or variations of them denote forward-looking information.

Forward-looking information is based upon a number of assumptions and is subject to a number of risks and uncertainties, many of which are beyond the Company's control that could cause actual results to differ materially from those that are disclosed in or implied by such forward-looking information. These risks and uncertainties include, but are not limited to, the risk that the FDA does not approve tesamorelin for the treatment of excess abdominal fat in HIV-infected patients with lipodystrophy, the risk that the payment of milestones is delayed or not received or that the royalties from the sale of tesamorelin are not received, the risk that the preparation of a New Drug Submission in Canada is delayed or is not completed, the risk that the Company is unable to enter into commercial agreements with third parties to qualify back-up suppliers of tesamorelin, and the risk that the timeline for preparing a conversion plan to IFRS is not met.

Although the forward-looking information contained herein is based upon what the Company believes are reasonable assumptions, investors are cautioned against placing undue reliance on this information since actual results may vary from the forward-looking information. Certain assumptions made in preparing the forward-looking information and the Company's objectives include the assumption, among others, that the FDA will approve tesamorelin for the treatment of excess abdominal fat in HIV-infected patients with lipodystrophy, sales of tesamorelin in the United States will be successful, no issue will occur in the preparation of a New Drug Submission in Canada, the Company is able to enter into commercial agreements with third parties to qualify back-up suppliers of tesamorelin, and the Company will not experience any difficulties in preparing a conversion plan to IFRS.

Consequently, all of the forward-looking information is qualified by the foregoing cautionary statements, and there can be no guarantee that the results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected

consequences or effects on the Company, its business, its financial condition or its results of operation. Furthermore, the forward-looking information reflects current expectations regarding future events only as of the date of release of this MD&A.

Investors are referred to the Company's public filings available at [www.sedar.com](http://www.sedar.com). In particular, further details on the risks and descriptions of the risks are disclosed in the "Risk and Uncertainties" section of the Company's Annual Information Form, dated February 23, 2010, for the year ended November 30, 2009. This MD&A is dated July 7, 2010, and has been approved by the Audit Committee.

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Consolidated Financial Statements of  
(Unaudited)

# **THERATECHNOLOGIES INC.**

Six-month periods ended May 31, 2010 and 2009

# **THERATECHNOLOGIES INC.**

Consolidated Financial Statements  
(Unaudited)

Periods ended May 31, 2010 and 2009

## **Financial Statements**

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# THE RATECHNOLOGIES INC.

Consolidated Balance Sheets  
(Unaudited)

May 31, 2010 and November 30, 2009  
(in thousands of dollars)

	May 31, 2010	November 30, 2009
<b>Assets</b>		
Current assets:		
Cash	\$ 3,497	\$ 1,519
Bonds	5,292	10,036
Accounts receivable	176	375
Tax credits receivable	2,002	1,666
Inventories	4,496	2,225
Research supplies	271	287
Prepaid expenses	663	302
	16,397	16,410
Bonds	40,259	51,807
Property and equipment	1,161	1,229
Other assets	41	41
	\$ 57,858	\$ 69,487
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,045	\$ 5,901
Current portion of deferred revenues (note 6)	6,852	6,847
	13,897	12,748
Deferred revenues (note 6)	10,268	13,691
Deferred lease inducements	42	–
Shareholders' equity:		
Capital stock (note 3)	279,329	279,169
Contributed surplus	6,948	6,484
Accumulated other comprehensive income	351	1,282
Deficit	(252,977)	(243,887)
	(252,626)	(242,605)
Total shareholders' equity	33,651	43,048
	\$ 57,858	\$ 69,487

See accompanying notes to unaudited consolidated financial statements.

# THE RATECHNOLOGIES INC.

Consolidated Statement of Operations  
(Unaudited)

Periods ended May 31, 2010 and 2009  
(in thousands of dollars, except per share amounts)

	May 31,		May 31,	
	2010	2009	2010	2009
	(3 months)		(6 months)	
Revenues:				
Royalties, technologies and other (note 6)	\$ 1,717	\$ 1,717	\$ 3,434	\$ 3,149
Interest	509	600	1,087	1,177
	2,226	2,317	4,521	4,326
Operating costs and expenses:				
Research and development	4,259	5,696	8,368	12,011
Tax credits	(167)	(422)	(335)	(1,090)
	4,092	5,274	8,033	10,921
General and administrative	2,057	1,857	3,858	4,178
Selling and market development	764	540	1,380	1,021
Patents	136	76	340	121
Fees associated with collaboration and licensing agreement (note 6)	—	—	—	4,269
	7,049	7,747	13,611	20,510
Net loss	\$ (4,823)	\$ (5,430)	\$ (9,090)	\$ (16,184)
Basic and diluted loss per share (note 3 (c))				
	\$ (0.08)	\$ (0.09)	\$ (0.15)	\$ (0.27)
Weighted average number of common shares outstanding				
	60,467,564	60,395,481	60,452,993	60,227,527

See accompanying notes to unaudited consolidated financial statements.

# TERATECHNOLOGIES INC.

Consolidated Statements of Comprehensive Loss  
(Unaudited)

Periods ended May 31, 2010 and 2009  
(In thousands of dollars)

	May 31,		May 31,	
	2010	2009	2010	2009
	(3 months)		(6 months)	
Net loss	\$ (4,823)	\$ (5,430)	\$ (9,090)	\$ (16,184)
Unrealized (losses) gains on available-for-sale financial assets	(740)	668	(737)	985
Reclassification adjustment for gains and losses on available-for-sale financial assets	(94)	(47)	(194)	(70)
Comprehensive loss	\$ (5,657)	\$ (4,809)	\$ (10,021)	\$ (15,269)

See accompanying notes to unaudited consolidated financial statements.

# THE RATECHNOLOGIES INC.

Consolidated Statements of Shareholders' Equity  
(Unaudited)

Six-month period ended May 31, 2010  
(In thousands of dollars)

	Capital stock		Contributed surplus	Accumulated other comprehensive income	Deficit	Total
	Number	Dollars				
Balance, November 30, 2009	60,429,393	\$ 279,169	\$ 6,484	\$ 1,282	\$ (243,887)	\$ 43,048
Issuance of share capital (note 3)	2,880	15	—	—	—	15
Exercise of stock options:						
Cash proceeds	55,161	91	—	—	—	91
Ascribed value	—	54	(54)	—	—	—
Stock-based compensation	—	—	518	—	—	518
Net loss	—	—	—	—	(9,090)	(9,090)
Unrealized gains on available-for-sale financial assets	—	—	—	(931)	—	(931)
Balance, May 31, 2010	60,487,434	\$ 279,329	\$ 6,948	\$ 351	\$ (252,977)	\$ 33,651

See accompanying notes to unaudited consolidated financial statements.

# THE RATECHNOLOGIES INC.

Consolidated Statements of Shareholders' Equity, Continued  
(Unaudited)

Six-month period ended May 31, 2009  
(In thousands of dollars)

	Capital stock		Contributed surplus	Accumulated other comprehensive income	Deficit	Total
	Number	Dollars				
Balance, November 30, 2008	58,215,090	\$ 269,219	\$ 5,585	\$ 372	\$ (228,230)	\$ 46,946
Change in accounting policies (note 2 (a))	-	-	-	-	(599)	(599)
Issuance of share capital (notes 3 and 6)	2,182,387	9,861	-	-	-	9,861
Stock-based compensation	-	-	500	-	-	500
Net loss	-	-	-	-	(16,184)	(16,184)
Unrealized gains on available-for-sale financial assets	-	-	-	915	-	915
Balance, May 31, 2009	60,397,477	\$ 279,080	\$ 6,085	\$ 1,287	\$ (245,013)	\$ 41,439

See accompanying notes to unaudited consolidated financial statements.

# TheraTechnologies Inc.

## Consolidated Statements of Cash Flows (Unaudited)

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

	May 31,		May 31,	
	2010	2009	2010	2009
	(3 months)		(6 months)	
<b>Cash flows from operating activities:</b>				
Net loss	\$ (4,823)	\$ (5,430)	\$ (9,090)	\$ (16,184)
Adjustments for:				
Amortization of property and equipment	135	147	282	284
Lease inducements and amortization	42	—	42	—
Stock-based compensation	259	295	518	500
	(4,387)	(4,988)	(8,248)	(15,400)
<b>Changes in operating assets and liabilities:</b>				
Interest receivable on bonds	216	167	379	(802)
Accounts receivable	105	283	199	359
Tax credits receivable	(168)	(422)	(336)	(1,090)
Inventories	(2,245)	—	(2,271)	(1,594)
Research supplies	(1)	93	16	226
Prepaid expenses	51	(67)	(361)	(126)
Accounts payable and accrued liabilities	3,046	(1,540)	1,266	(1,668)
Deferred revenues	(1,715)	(1,714)	(3,418)	23,967
	(711)	(3,200)	(4,526)	19,272
	(5,098)	(8,188)	(12,774)	3,872
<b>Cash flows from financing activities:</b>				
Share issuance	68	7	106	9,861
Share issue costs	—	—	—	(8)
	68	7	106	9,853
<b>Cash flows from investing activities:</b>				
Additions to property and equipment	(161)	(133)	(336)	(235)
Acquisition of bonds	—	—	—	(19,631)
Disposal of bonds	5,356	5,257	14,982	9,842
	5,195	5,124	14,646	(10,024)
Net increase (decrease) in cash	165	(3,057)	1,978	3,701
Cash, beginning of period	3,332	6,891	1,519	133
Cash, end of period	\$ 3,497	\$ 3,834	\$ 3,497	\$ 3,834

See note 4 (a) for supplemental cash flow information.

See accompanying notes to unaudited consolidated financial statements.

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements  
(Unaudited)

Periods ended May 31, 2010 and 2009  
(in thousands of dollars, except per share amounts)

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## 1. Basis of presentation:

The financial statements included in this report are unaudited and reflect normal and recurring adjustments which are, in the opinion of the Company, considered necessary for a fair presentation of its results. These financial statements have been prepared in conformity with Canadian generally accepted accounting principles ("GAAP"). The same accounting policies as described in the Company's latest annual report have been used. However, these financial statements do not include all disclosures required under GAAP and, accordingly, should be read in connection with the financial statements and the notes thereto included in the Company's latest annual report. These interim financial statements have not been reviewed by the auditors.

## 2. New accounting policies:

(a) Adoption of new accounting standards:

### Goodwill and intangible assets

Effective with the commencement of its 2009 fiscal year, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook 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, whether these assets are separately acquired or internally developed. The impact of adopting this standard has been to increase the opening deficit and to reduce other assets as at December 1, 2008 by \$599, respectively, which is the amount of patent costs related to periods prior to these dates.

### Lease inducements

Lease inducements arising from leasehold improvements allowance and rent-free inducements received are deferred and amortized over the term of the lease on a straight-line basis.

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
(Unaudited)

Periods ended May 31, 2010 and 2009  
(in thousands of dollars, except per share amounts)

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## 2. New accounting policies (continued):

### (b) Future accounting changes:

#### 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 International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. 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 is in a process to determine the impact of adopting the standards on its consolidated financial statements.

## 3. Capital stock:

During the second quarter of 2010, the Company received subscriptions in the amount of \$15 (\$7 for the same period in 2009) for the issue of 2,880 common shares (2,550 for the same period in 2009) in connection with its share purchase plan.

### (a) Shareholder rights plan:

On February 10, 2010, the Board of Directors of the Company adopted a shareholder rights plan (the "Plan"), effective as of such date. The Plan is designed to provide adequate time for the Board of Directors, and the shareholders, to assess an unsolicited takeover bid for the Company. In addition, the Plan provides the Board of Directors with sufficient time to explore and develop alternatives for maximizing shareholder value if a takeover bid is made, as well as provide shareholders with an equal opportunity to participate in a takeover bid and receive full and fair value for their common shares (the "Common Shares"). The Plan, if approved by the shareholders, will expire at the close of the Company's annual meeting of shareholders in 2013.

The rights issued under the Plan will initially attach to and trade with the Common Shares and no separate certificates will be issued unless an event triggering these rights occurs. The rights will become exercisable only when a person, including any party related to it, acquires or attempts to acquire 20% or more of the outstanding Common Shares without complying with the "Permitted Bid" provisions of the Plan or without approval of the Board of Directors. Should such an acquisition occur or be announced, each right would, upon exercise, entitle a rights holder, other than the acquiring person and related persons, to purchase Common Shares at a 50% discount to the market price at the time.

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
(Unaudited)

Periods ended May 31, 2010 and 2009  
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### 3. Capital stock (continued):

(a) Shareholder rights plan (continued):

Under the Plan, a Permitted Bid is a bid made to all holders of the Common Shares and which is open for acceptance for no less than 60 days. If, at the end of the 60-day period, at least 50% of the outstanding Common Shares, other than those owned by the offeror and certain related parties, have been tendered, the offeror may take up and pay for the Common Shares but must extend the bid for a further 10 days to allow other shareholders to tender.

(b) Stock option plan:

Changes in outstanding options granted under the Company's stock option plan for the year ended November 30, 2009 and the six-month period ended May 31, 2010 were as follows:

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	Number	Weighted average exercise price per share
Options as at November 30, 2008	2,161,800	\$ 6.52
Granted	680,500	1.83
Cancelled and expired	(176,500)	8.34
Options as at November 30, 2009	2,665,800	5.20
Granted	265,000	3.84
Cancelled and expired	(37,667)	4.61
Exercised	(55,161)	1.66
Options as at May 31, 2010	2,837,972	\$ 5.15

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# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
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### 3. Capital stock (continued):

(c) 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:

	2010	2009
Risk-free interest rate	2.46%	1.80%
Volatility	81%	79%
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 that similar grants have remained outstanding in the past. Dividend yield was excluded from the calculation, since it is the present policy of the Company not to retain in cash in order to keep funds available to finance the Company's growth.

The following table summarizes the weighted average fair value of stock options granted during the periods ended May 31, 2010 and 2009:

Periods ended May 31 (6 months)	Number of options	Weighted average grant-date fair value
2010	265,000	\$ 2.96
2009	660,500	1.24

Periods ended May 31 (3 months)	Number of options	Weighted average grant-date fair value
2010	-	\$ -
2009	70,000	1.27

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
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Periods ended May 31, 2010 and 2009  
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### 3. Capital stock (continued):

(d) Diluted loss per share:

Diluted loss per share was not presented as the effect of options would have been anti-dilutive. All options outstanding at the end of the year could potentially dilute the basic earnings per share in the future.

### 4. Supplemental information:

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

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	May 31, 2010	November 30, 2009
Additions to property and equipment included in accounts payable and accrued liabilities	\$ 61	\$ 183

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(b) For the six-month period ended May 31, 2010, the Company has reclassified in net loss \$194 of realized gains on available-for-sale financial assets previously recorded in accumulated other comprehensive income (\$70 in 2009).

On May 31, 2010, the accumulated other comprehensive loss was composed of unrealized gains on available-for-sale financial assets of \$351 (gains of \$1,282 on November 30, 2009).

(c) For the periods ended May 31, 2010 and 2009, the following items were included in the determination of the Company's net loss:

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	2010	2009
Amortization of property and equipment	\$ 282	\$ 284
Stock-based compensation	518	500

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### 5. 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 these instruments.

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
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Periods ended May 31, 2010 and 2009  
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## 5. Financial instruments (continued):

### (a) Carrying value and fair value (continued):

Bonds and investments in public companies are stated at estimated fair value, determined by inputs that are directly observable (Level 2 inputs).

### (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 \$135 (\$727 in 2009) for the six-month period ended May 31, 2010.

## 6. Collaboration and licensing agreement:

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

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, 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 increasing royalties on annual net sales of tesamorelin in the United States, if applicable.

The initial payment of \$27,097 has been deferred and is being amortized over its estimated service period on a straight-line basis. This period may be modified in the future based on additional information that may be received by the Company. For the six-month period ended May 31, 2010, an amount of \$3,423 related to this transaction was recognized as revenue. At May 31, 2010, the deferred revenues related to this transaction amounted to \$17,114.

# THE RATECHNOLOGIES INC.

Notes to Consolidated Financial Statements, Continued  
(Unaudited)

Periods ended May 31, 2010 and 2009  
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## **6. Collaboration and licensing agreement (continued):**

On August 12, 2009, the US Food and Drug Administration accepted the New Drug Application ("NDA") made by the Company for tesamorelin. Under the terms of the Company's Collaboration and Licensing Agreement with EMD Serono, the acceptance of the tesamorelin NDA resulted in a milestone payment of US\$10,000 (CAD\$10,884). This milestone payment has been recorded in the third quarter of 2009.

The Company may conduct research and development for additional indications. Under the Collaboration and Licensing Agreement, EMD Serono will have the option to commercialize additional indications for tesamorelin in the United States. 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.