

*Consolidated interim financial statements of*

**OSTA BIOTECHNOLOGIES INC.**

**March 31, 2007**

*(Unaudited)*

**OSTA BIOTECHNOLOGIES INC.**

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## **NOTICE TO READER**

Management of the Company has prepared these interim unaudited financial statements and notes and is responsible for the integrity and fairness of the financial information presented therein. These have been reviewed and approved by the Company's Audit Committee and the Board of Directors. The Company's auditors have not reviewed or audited these interim unaudited financial statements.

**OSTA BIOTECHNOLOGIES INC.**  
*(Incorporated under the Canada Business Corporations Act)*  
**Consolidated Interim Balance Sheets**  
*(Unaudited)*

	As at March 31, 2007	As at December 31, 2006
	\$	\$
<b>Assets</b>		
Current		
Cash	129,248	118,015
Short-term investments	900,784	1,138,088
Receivables	707	707
Investment tax credits receivable	175,392	151,680
Prepaid expenses	7,725	
	<b>1,213,856</b>	<b>1,408,490</b>
Property and equipment	11,995	12,967
Patents	320,239	301,489
Licenses	35,276	30,780
	<b>1,581,365</b>	<b>1,753,726</b>
<b>Liabilities</b>		
Current		
Accounts payable and accrued liabilities	107,586	112,367
	<b>107,586</b>	<b>112,367</b>
Contingencies and commitments		
<b>Shareholders' equity</b>		
Capital stock	3,492,776	3,492,776
Contributed surplus	671,114	645,888
Deficit	(2,690,141)	(2,497,305)
	<b>1,473,779</b>	<b>1,641,359</b>
	<b>1,581,365</b>	<b>1,753,726</b>

*See accompanying notes to consolidated financial statements.*

**Approved on Behalf of the Board:**

..... Director  
Ajay Gupta

..... Director  
Leontis Teryazos

**OSTA BIOTECHNOLOGIES INC.**  
**Consolidated Interim Statements of Deficit**  
*(Unaudited)*

	Three month Period ended March 31, 2007 \$	Three month Period ended March 31, 2006 \$
<b>Deficit - beginning period</b>	<b>(2,497,306)</b>	(1,646,465)
Net loss	<b>(192,835)</b>	(207,318)
<b>Deficit - end of period</b>	<b>(2,690,141)</b>	(1,853,783)

*See accompanying notes to consolidated financial statements.*

**OSTA BIOTECHNOLOGIES INC.**  
**Consolidated Interim Statements of Loss**  
*(Unaudited)*

	<b>Three month Period ended March 31, 2007</b>	Three month Period ended March 31, 2006
	\$	\$
<b>Investment income</b>	<b>1,356</b>	6,025
<b>Expenses</b>		
Salaries and wage levies	<b>68,762</b>	76,712
Professional and consulting fees	<b>76,200</b>	54,365
Financing fees	<b>5,000</b>	
Travel and automobile	<b>3,631</b>	4,626
Office and general	<b>4,324</b>	10,434
Interest and bank charges	<b>94</b>	92
Taxes and insurance	<b>5,784</b>	6,151
Other research costs	<b>27,375</b>	8,000
Research and development tax credits	<b>(23,712)</b>	(20,217)
Stock option compensation	<b>25,255</b>	71,429
Amortization	<b>1,478</b>	1,751
	<b>194,191</b>	213,343
<b>Net loss</b>	<b>(192,835)</b>	(207,318)
Loss per share basic and diluted	<b>(0.0059)</b>	(0.00732)
Weighted average number of common shares outstanding for the year	<b>32,706,196</b>	28,305,219

*See accompanying notes to consolidated financial statements.*

**OSTA BIOTECHNOLOGIES INC.**  
**Consolidated Interim Statements of Cash Flows**  
*(Unaudited)*

	<b>Three month Period ended March 31, 2007</b>	Three month Period ended March 31, 2006
	\$	\$
<b>Cash flows from (used in) operating activities</b>		
Net loss	(192,835)	(207,318)
Amortization of property and equipment	1,062	1,246
Amortization of licences	416	505
Stock option compensation	25,255	71,429
	<b>(166,102)</b>	<b>(134,138)</b>
Changes in non-cash working capital	(36,218)	(32,244)
	<b>(202,320)</b>	<b>(166,382)</b>
<b>Cash flows from (used in) investing activities</b>		
Redemption of short-term investments	237,304	174,978
Acquisition of property and equipment		(2,346)
Patents	(18,750)	(9,262)
Acquisition of intangible assets	(5,000)	
	<b>213,553</b>	<b>163,370</b>
<b>Cash flows from (used in) financing activities</b>		
Net increase (decrease) in cash	11,233	(3,012)
Cash - beginning of year	118,015	125,210
<b>Cash - end of year</b>	<b>129,248</b>	<b>122,198</b>

*See accompanying notes to consolidated financial statements.*

**OSTA BIOTECHNOLOGIES INC.**  
**Notes to Consolidated Interim Financial Statements**  
**March 2007**  
*(Unaudited)*

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**1. Nature of business**

The Company is a biopharmaceutical company whose principal business is to carry out research and development work for the development of diagnostic and therapeutic products specific to Alzheimer's disease, osteoporosis, cancer and rickets.

**2. Significant accounting policies**

*Basis of presentation*

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary Osta Biopharma Inc.

*Use of estimates*

The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount 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. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods may be significant.

*Cash and cash equivalents*

Highly liquid investments with a maturity of three months or less from the date of purchase are classified as cash and cash equivalents. High liquid investments with a maturity of more than three months are classified as short-term investments.

*Property and equipment*

Property and equipment are recorded at cost and amortized over their estimated useful lives, as follows:

*On the declining balance method -*

Office equipment	-	30%
Lab equipment	-	30%

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*(Unaudited)*

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**2. Significant accountings policies (cont'd.)**

***Patents***

Patent costs are to be amortized on a straight line basis over the expected useful lives of the related patents, ranging from 11 years to 19 years. The amortization will commence upon final approval of the related patents by the regulatory authorities.

***Licenses***

The licenses are amortized on a straight line basis over the remaining life of the underlying patents.

***Research and development***

The Company annually incurs costs on activities that relate to research and development of new products. Research costs are expensed as they are incurred. The Company has also expensed development costs as incurred because the costs do not meet the generally accepted criteria for deferral and amortization. Costs are reduced by investment tax credits where applicable.

***Investment tax credits***

The Company claims investment tax credits as a result of incurring scientific research and experimental development expenditures. Investment tax credits are recognized when the related expenditures are incurred and there is reasonable assurance of their realization. Management has made a number estimates and assumptions in determining the expenditures eligible for the investment tax credit claim. It is possible that the allowed amount of the investment tax credit claim could be materially different from the recorded amount upon assessment by the governments.

***Income taxes***

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are accounted for based on the difference between the carrying amounts and tax basis of assets and liabilities and are measured using enacted tax rates and laws in effect as at the date of the financial statements. Changes in these balances are charged to income of the year in which they arise. Future tax assets are accounted for only if management believes it is more likely then not that they will be realized.

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**2. Significant accounting policies (cont'd.)**

*Stock based compensation plan*

The Company has adopted the recommendations of the Canadian Institute of Chartered Accountants' Handbook Section 3870, entitled "Stock Based Compensation and Other Stock Based Payments". Under this method, the fair value of options granted to directors, officers, employees and technical consultants, is recognized over the applicable vesting period, based on the estimated fair value of the options on the grant date determined using an option-pricing model. The expense is charged to stock option compensation expense with a corresponding credit to contributed surplus. When the options are exercised, capital stock is credited by the sum of the consideration paid, together with the related portion previously recorded as contributed surplus.

*Share issue costs*

Share issue costs are charged against the deficit in the year incurred.

*Loss per share*

Basic loss per common share is calculated by dividing the applicable net loss by the weighted average number of shares outstanding during the year. Diluted loss per common share is calculated by dividing the applicable net loss by the sum of the weighted average number of shares outstanding during the year based on the application of the treasury stock method for the calculation of the dilutive effect of stock options.

The computation of diluted loss per common share is equal to the basic loss per common share due to the anti-dilutive effect of the stock options.

*Future accounting changes*

In January 2005, the CICA issued Handbook Section 1530, "Comprehensive Income", Section 3251, "Equity", Section 3855, "Financial Instruments – Recognition and Measurement" and Section 3865, "Hedges". These new standards will require the following:

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**2. Significant accounting policies (cont'd.)**

- Financial assets will be classified as either held-to-maturity, held-for-trading, loans and receivables or available-for-sale. Held-to-maturity classification will be restricted to fixed maturity instruments that the Company intends and is able to hold to maturity and will be accounted for at the discounted amount, based on the effective interest method. Held-for-trading instruments will be recorded at fair value each period with realized and unrealized gains and losses reported in net income. Loans and receivables will be accounted for at the discounted amount, based on the effective interest method. The remaining financial assets will be classified as available-for-sale. These will be recorded at fair value each period with unrealized gains and losses reported in a new category of the Consolidated Balance Sheet under shareholders' equity called other comprehensive income ("OCI");
- Financial liabilities will be classified as either held-for-trading or other liabilities. Held-for-trading instruments will be recorded at fair value each period with realized and unrealized gains and losses reported in net income. Other instruments will be accounted for at amortized cost with gains and losses reported in net income in the period that the liability is derecognized;
- Derivatives will be classified as held-for-trading unless designated as hedging instruments. All derivatives, including embedded derivatives that must be separately accounted for, will be recorded at fair value each period on the Consolidated Balance Sheet; and
- A new financial statement, Consolidated Statement of Comprehensive Income, has been introduced. Comprehensive income is defined as all changes in equity other than those resulting from investments by owners and distributions to owners. Comprehensive income is comprised of two components, net income and OCI. OCI refers to amounts that are recorded as an element of shareholders' equity but are excluded from net income because these transactions or events were attributed to changes from non-owner sources.

The guidance will apply for interim and annual financial statements relating to fiscal years beginning on or after December 31, 2006. Although Osta Biotechnologies is in the process of evaluating the impact of these standards, the Company does not expect these standards to have a material impact on its consolidated financial statements.

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**3. Short-term investments**

Short-term investments consist of guaranteed investment certificates and discount notes bearing interest at 3.80%, with maturity date of December, 2007.

**4. Licenses**

The licenses acquired allow the Company to perform research on patented technology. The licenses have a net carrying amount of \$35,275, net of accumulated amortization of \$3,725.

**5. Capital stock**

The authorized, issued and fully paid capital stock consists of the following:

*Authorized:* An unlimited number of common shares and an unlimited number of preferred shares without nominal or par value.

*Issued:*

<b>March 31, 2007</b>	December 31 2006		<b>March 31 2007</b>	December 31 2006
<b>#</b>	<b>#</b>		<b>\$</b>	<b>\$</b>
<b>32,706,196</b>	32,706,196	Common Shares	<b>3,492,776</b>	3,492,776

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**6. Incentive stock options**

The Company maintains an incentive stock option plan (the "Stock Option Plan") which provides that the Board of Directors of the Company may from time to time, in its discretion, grant to directors, officers, employees and technical consultants of the Company, non-transferable options to purchase common shares for a period of up to five (5) years, provided that the number of common shares reserved for issuance under the Stock Option Plan does not exceed 4 million shares. The Board of Directors determines the price per common share and the number of common shares that may be allotted to each director, officer, employee and consultant of the Company and all other terms and conditions of the options granted under the Stock Option Plan.

The Company has accounted for options granted using the fair value method. The fair value of the options granted after May 3, 2005 was estimated using the Black-Scholes option pricing model based on the

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**6. Incentive stock Options (cont'nd)**

following assumptions:

Risk-free interest rate	Between 3.53% and 4.08%
Expected volatility	71%
Dividend yield	Nil
Average expected life	Between 3 months and 5 years
Fair value on grant date	Between \$0.154 - \$0.215

The fair value of options granted before May 3, 2005 was estimated using the Black-Scholes option pricing model based on the following assumptions:

Risk-free interest rate	Between 3.00% and 4.01%
Expected volatility	36%
Dividend yield	Nil
Average expected life	Between 3 months and 5 years
Fair value on grant date	Between \$0.066 - \$0.131

A summary of changes in the company's common share purchase options is presented below:

	<b>March 2007</b>	
	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
	#	\$
Balance - beginning of period	<b>3,310,000</b>	<b>0.3453</b>
Shares reserved for options granted under Osta option plan		-
Granted during the period	<b>300,000</b>	<b>0.25</b>
Expired during the period	<b>(15,000)</b>	<b>0.35</b>
Balance - end of period	<b>3,595,000</b>	<b>0.3373</b>

Common share purchase options outstanding, exercisable, granted to directors, officers and consultants of the Company as at March 31, 2007 are summarized as follows:

<b>Number of Options</b>	<b>Exercise Price</b>	<b>Expiry Date</b>
#	\$	
235,000	0.30	November 2007
450,000	0.35	December 2007
20,000	0.35	June 2008
20,000	0.30	July 2008
300,000	0.25	August 2008
10,000	0.35	October 2008

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385,000	0.35	April 2009 to June 2009
1,750,000	0.35	March 2010 to December 2010
425,000	0.35	January to February 2011

**7. Contingencies and commitments**

A. The Company has entered into two licensing agreements with a licensor with the following terms and conditions.

*(i) Royalties*

a) A minimum annual royalty of \$5,000 is due on each of the two licenses commencing in 2006.

b) Royalties due to the licensor for each of the two licenses are calculated as follows:

The greater of \$5,000 or;

- on the first \$100 M. of net revenues; 2% and 2.5% respectively;
- on net revenues between \$100 M. and \$300 M.; 1.5% and 2% respectively;
- 
- on net revenues greater than \$300 M.; 1% for both licenses.

Net revenues are specifically defined in both licensing agreements.

*(ii)* On one license, a milestone fee of \$25,000 is due upon acceptance of an "investigational new drug application" with the United States Food and Drug Administration (FDA) or its equivalent in another jurisdiction. A further milestone of \$100,000 is due on this license pursuant to the company realizing \$1 M. of gross revenue as specifically defined in the license agreement on sales of products related to this license.

*(iii)* Marketing approval fees of \$200,000 and \$150,000 respectively are payable to the licensor on the licences upon approval by the FDA or other regulatory agencies for the manufacture and sale of licensed products.

*(iv)* Under the terms of one of the licence agreements, the Company has committed to allocating a minimum of \$40,000 per year for the further development of technology for two years commencing February 2004.

B. The Company entered into two licensing agreements with a second licensor having the following terms and conditions

*(i)* In consideration of the licenses granted herein and the costs incurred therefore, Licensee shall pay to Licensor a license issue fee of \$5,000 for one of the licenses, payable 30 days upon the Effective Date of the Agreement. As at December 31, 2006, the fee has been accrued in the Company's records.

*(ii)* (a) A minimum annual royalty of \$5,000 is due on each license commencing in 2009.

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**7. Contingencies and commitments (cont'd.)**

- (b) Royalties due to the licensor for each of the two licenses are to be calculated as follows:
- 2.5% of the first \$100 M. of net revenues;
  - 2.0% of net revenues between \$100 M. and \$300 M.
  - 1% of net revenues in excess of \$300 M.

Net revenues are specifically defined in the licensing agreement.

- (iii) Milestone fees for both licenses of \$25,000 per product are due to the licensor upon acceptance of an "investigational new drug application" with the United States Food and Drug Administration (FDA). A further milestone of \$100,000 is due to the licensor pursuant to the Company realizing \$1 M of gross revenue as specifically defined in the license agreement on sales of products related to the specific licenses.
- (iv) A marketing approval fee for both licenses of \$100,000 per product is to be paid to the licensor pursuant to FDA approval for the manufacture and sale of products based on the license patents defined in each of the agreements.

C. The Company has entered into a licensing agreement with a third licensor having the following terms and conditions:

- (i) In consideration for the license granted in this Agreement, Licensee shall pay to Licensor an annual earned royalty on Net Sales of Licensed Products sold by Licensee and its Sublicensee(s) in the following manner:
- 2.25% of Net Sales for up to and including \$100 M. per annum;
  - 1.75% of Net Sales greater than \$100 M. per annum and up to and including \$500 M. per annum; and
  - 1.5% of Net Sales greater than \$500 M. per annum.
- (ii) In consideration for the license granted herein, Licensee shall pay to Licensor the following amounts within 30 days of achievement of the following milestones:
- \$10,000 upon submission of an Investigational New Drug ("IND") Application to the United States Food & Drug Administration ("FDA") or European Union equivalent for a License Product,
  - \$25,000 upon the initiation of the first Phase II clinical trial for a Licensed Product,
  - \$50,000 upon initiation of the first Phase III clinical trial for a Licensed Product,
  - 100,000 upon the first approval action letter issued by the FDA or European Union equivalent with respect to a New Drug Application for a Licensed Product ("FDA" Approval), and
  - \$500,000 upon Licensee and/or its Sublicensee(s) reaching Net Sales of Licensed Product of \$100 M.

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- (iii) As a condition to maintain the license granted herein, subject to the terms and conditions of this Agreement, Licensee shall pay to Licensor minimum annual royalties of:
- \$2,500 payable on the first anniversary of the Effective Date,
  - \$5,000 payable on the second anniversary of the Effective Date, and
  - \$10,000 payable on the third anniversary of the Effective Date and through each subsequent anniversary.
  - Licensee shall pay to Licensor a minimum royalty of \$25,000 on each anniversary of the Effective Date upon the first Commercial Sale of Licensed Product.
- (iv) As a minimum, Licensee must invest in aggregate \$40,000 per year into the laboratories of the Principal Investigators for research and development of the Licensed Technology for the first two years of this Agreement via a separate research and development agreement with Queens University and in addition Licensee must invest in aggregate at least \$40,000 for each year thereafter toward patent protection, development and commercialization of a Licensed Product.

**8. Related party transactions**

The company entered into the following transactions with its officers and shareholders:

	<b>3 month period ended March 31</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
Consulting fees paid to officers and shareholders	<b>54,200</b>	58,325

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

**9. Subsequent Events**

In a press release dated April 17, 2007, the Company announced that it had completed a private placement in the amount of \$500,000 by issuing a total of 2,000,000 units at a price of \$0.25 per unit. Each unit consists of one common share of Osta and one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share at a price of \$0.40 per share until April 17, 2009. The closing of this private placement has increased the number of outstanding common shares of Osta to 34,706,196.

**10. Financial Instruments**

*Fair value*

Cash, short-term investments, receivables, accounts payable and accrued liabilities are all short-term in nature and as such, their carrying values approximate fair values.

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**11. Comparative Figures**

Certain reclassifications of 2006 amounts have been made in order to conform to the method of presentation adopted in the current year.