



## **OSTA BIOTECHNOLOGIES INC.**

### **Management's Discussion and Analysis**

**For the three month period ended  
March 31, 2010**

## **INTRODUCTION**

The following discussion is management's analysis of the consolidated operating and financial data for Osta Biotechnologies Inc. (the "Company") and its wholly owned subsidiary, Osta BioPharma Inc. ("Osta"), for the three month period ended March 31, 2010. It should be read in conjunction with the accompanying consolidated unaudited financial statements and related notes for the three month period ended March 31, 2010 prepared in accordance with Canadian generally accepted accounting principles taking into account material events up to May 27, 2010. All amounts are expressed in Canadian dollars.

### **Inherent Risk Factors**

The Company's products and technologies are currently in the research and developmental stage. The Company does not and may never have viable products approved for commercialization. To date, the Company has not generated any revenues other than from ancillary investment income. The Company's financial condition will depend on its ability to obtain additional funding through the capital markets. The availability of such funding may not be under favorable terms or may not be available at all. The ability of the Company to successfully obtain additional financing in the future will depend partly on the condition of capital markets at the time and partly of the future performance of the Company.

### **Forward Looking Statements**

The following discussion contains forward looking statements regarding the Company's financial condition and the results of operation that are based on its consolidated financial statements. The Company operates in a highly competitive environment that involves significant risks and uncertainties, some of which are outside the Company's control. The Company is subject to risks inherent in the biopharmaceutical industry, including risks associated with research, preclinical testing, manufacture of drug substance to support clinical studies, toxicology studies, uncertainty of regulatory agencies, enforcement and protection of the Company's patent portfolio, the need for future capital, potential competitors, the ability to attract and maintain collaborative partners, dependence on key personnel and the ability to successfully market the Company's product candidates. The Company's actual results could differ materially from those expressed or implied in these forward looking statements. For a more detailed discussion of related risks, please refer to the Company's public filings available on [www.sedar.com](http://www.sedar.com).

## **CHANGES IN ACCOUNTING POLICIES**

### *Consolidated financial statements and non-controlling interest*

In January 2008, the Canada's Accounting Standard's Board (AcSB) released Section 1601 - Consolidated Financial Statements and Section 1602 - Non-Controlling Interest, which replace

Section 1600 - Consolidated Financial statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the consolidated financial statements of the parent, subsequent to a business combination. Section 1602 is equivalent to the corresponding provisions of International Accounting Standards (IAS 27) - Consolidated and Separate Financial Statements.

These sections apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. These sections must be applied together with section 1582 "Business Combinations" if they are implemented for a fiscal year beginning before January 1, 2011.

#### *Harmonizing of Canadian and International Standards*

In February 2008, Canada's Accounting Standards Board (AcSB) confirmed that Canadian GAAP, as used by publicly accountable enterprises, will be fully converged with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS-IASB"). As a result, the Company will be required, commencing with its first interim period following the changeover date (January 1, 2011) to report under IFRS-IASB standards instead of current Canadian GAAP. As of January 1, 2010, called the transition date, the Company will be required to prepare an opening balance sheet (called a Statement of Financial Position) under IFRS-IASB, however, the Company's interim and annual financial statements for the fiscal year-ending December 31, 2010 will continue to be prepared using Canadian GAAP.

The transition to IFRS requires the Company to apply IFRS 1 in order to prepare IFRS-IASB compliant financial statements in the first reporting period after the changeover date. IFRS 1 only applies at the time of changeover and includes a requirement for retrospective application of each IFRS as if it had always been in effect. IFRS 1 also mandates certain exceptions to retrospective application as well as certain optional exemptions from retrospective application in order to ease the burden of transition to IFRS-IASB from any previous GAAP.

The transition to IFRS-IASB will require the Company to do an in-depth analysis and review of its current accounting policies and business practices in order to ensure that its' systems and reporting methods are ready for the transition. As of December 31, 2009, the Company has not yet begun to work on its IFRS conversion plan, however, management is in the process of engaging an IFRS specialist who will be able to assist the Company with its' transition by commencing the required review, determining which IFRS's will apply to the Company, as well as where the major differences (if any) are between Canadian GAAP and IFRS-IASB. Management will then begin the process of implementing any required changes in order to be ready to report under IFRS as of the changeover date.

Given the current level of the Company's operations, management is of the opinion that this timeframe gives the Company sufficient time to meet its obligations with respect to the changeover to IFRS.

Further updates on implementation progress and potential reporting impact from the adoption of IFRS will be provided during the implementation period.

## **SELECTED FINANCIAL INFORMATION**

The selected financial information provided below is derived from our unaudited quarterly consolidated financial statements for each of the last five quarters:

<b>Summary of Quarterly results</b>						
	Net Loss			Loss per share		
Quarter	2010	2009	2008	2010	2009	2008
Q1	\$105,210	\$133,744	\$195,792	.0030	.0038	.0055
Q2		\$233,880	\$180,279		.0066	.0051
Q3		\$135,118	\$147,570		.0038	.0042
Q4		\$ 44,193	\$ 63,531		.0012	.0018

## **Consolidation of Financial Statements**

For the three month period ended March 31, 2010, the financial statements of the Company and Osta are presented on a consolidated basis. All intercompany transactions and balances have been eliminated upon consolidation.

## **Outstanding Shares**

At March 31, 2010, the Company had 35,386,528 (2009 - 35,386,528) common shares issued and outstanding. Options to acquire an aggregate of 3,175,000 common shares have been granted to directors, officers and consultants of the Company pursuant to the terms of the Company's incentive stock option plan. In addition, 5,071,772 Common Shares have been reserved for issuance pursuant to all outstanding common share purchase warrants.

On March 4, 2010, options to acquire an aggregate 100,000 common shares at an exercise price of \$0.35 per share expired.

On April 1, 2010, the Company completed a private placement of gross proceeds of \$504,000 by issuing a total of 8,400,000 units at a price of \$0.06 per unit. Each unit consists of one common share of Osta Biotechnologies Inc. and one half common share purchase warrant. Each whole common share warrant entitles the holder to purchase one additional common share at a price of \$0.10 per share until April 1, 2012. As compensation, the Underwriters were paid a commission of \$35,280 and were granted a non-transferable broker warrant allowing them to purchase 588,000 common shares of the Company at a price of \$0.10 per share until April 1, 2012.

The securities issued in connection with the private placement are subject to a four-month hold period, expiring on August 2, 2010, in compliance with the policies of the TSX Venture Exchange and applicable securities legislation. As a result of the closing of the private placement, Osta has 43,786,528 issued and outstanding common shares.

On May 3, 2010, options to acquire an aggregate 850,000 common shares at an exercise price of \$0.35 per share expired.

Other than indicated above, as of May 27, 2010, there have been no other changes to the outstanding shares and no other issuance of stock options or warrants.

## **RESULTS OF OPERATIONS**

The Company is engaged in research and development and does not have any products that are presently at the commercialization stage. The Company continues to incur expenses related to research and development and as such anticipates that losses will continue until such time as the Company is able to successfully commercialize one of its products, which may never occur.

### **Recoverable research grant**

On October 21, 2008, the Company announced that it received funding from the Institute for Study of Aging (ISOA) in the form of a recoverable grant of up to \$247,106 US Dollars to develop a novel class of drugs for Alzheimer's disease. "ISOA" is a private foundation established by the Estee Lauder family in 1998.

Under the terms of the refundable grant, all funds granted, and any interest or earnings earned thereon, until expended for the purposes of the project, shall not be used for any other purpose and shall not be invested in any manner that would jeopardize or impair their availability either for the use by the Company for the purpose of the project or for the return to "ISOA". Such funds shall not serve as security for any indebtedness of the Company for any money borrowed, loaned or guaranteed. Any portion of the funds not used for the purposes of the project shall be repaid to "ISOA". As at March 31, 2010, the Company received \$177,375 CDN Dollars (\$150,000 US Dollars) of which the unexpended balance of the funds received was \$43,440 including interest earned. The balance of \$97,106 US funds is to be issued upon ISOA's receipt of a satisfactory research report indicating that the initial funds have been expended.

Title to any discoveries, inventions, developments, data and substances made, conceived or reduced to practice by the Company, its employees, contractors or agents during the performance of the research project or as a result of the project, including any patents, patent applications, copyrights and applications and registrations thereof, and all other intellectual property rights, title and ownership interest relating thereto will vest with the Company.

### **Investment Income**

During the three month period ended March 31, 2010, the Company had revenues of \$206 consisting of interest income as compared to \$1,866 for the three month period ended March 31,

2009. The decrease in revenue is due to a substantial decrease in interest rates offered by the financial institutions as well as a reduction in cash and cash equivalents available for short-term investments.

## Expenses

The Company had gross expenses (before the change in fair value of convertible debt of \$111 during three month period ended March 31, 2010 of \$105,305 as compared to \$129,017 (before the change in fair value of convertible debt of \$6,593) during three month period ended March 31, 2009. The decrease in gross expenses is primarily due to the decrease in research and development costs, professional and consulting fees and stock option compensation granted to consultants of the company.

## Research and Development Expenses

During the three months ended March 31, 2010, the Company spent \$57,264 on research and development (R&D) as compared to \$65,020 for the three month period ended March 31, 2009. These expenses are comprised of \$30,713 of salaries (March 31, 2009 - \$30,713), \$10,640 of subcontracts (March 31, 2009 - \$33,340) and patent costs of \$15,912 (March 31, 2010 - \$967). The reduction in research expenses is also due mainly to a prioritization of ongoing research projects resulting from a more concerted effort by management to manage cash flow requirements.

All the expenses were for the development of a novel drug for cancer and Alzheimer's disease.

## General & Administrative Expenses

During the three month period ended March 31, 2010, the Company spent \$57,852 on general and administrative expenses as compared to \$84,090 for the three month period ended March 31, 2009. The breakdown of these expenses is as follows:

	2010	2009
	\$	\$
Salaries and wage levies	21,196	21,147
Professional and consulting fees	28,347	40,439
Total administrative labor costs before stock option compensation	49,543	61,586
Stock option compensation	1,274	8,422
Interest on long-term convertible debt	1,952	2,335
Other amounts	4,972	5,154
Administrative expenses before change in value of convertible debt	57,741	77,497
Change in fair value of convertible debt	111	6,593
Total administrative expenses	<u>57,852</u>	<u>84,090</u>

The decrease in general and administrative expenses is due mainly to a reduction of professional and consulting fees, stock option compensation and interest on long-term convertible debt. The

reduction in professional and consulting fees is as a result of managements' continuous effort to monitor and maintain low overhead costs. The reduction of stock option compensation, a non cash expense, is due to the timing of the issue of stock options granted in 2009 and the decrease in interest on long-term convertible debt is due to a lower average \$US exchange rate for the three months ended March 31, 2010 as opposed to the average \$US exchange rate in the prior year.

## **Summary of Research and Development Activities**

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

Based on the availability of limited funds, the Company has put priorities on the development of a novel drug for cancer chemotherapy and a novel drug for the treatment of Alzheimer's disease. As a result, the Company has put all other research and development programs on hold until further financing has been secured.

### ***Cancers Therapeutic Agent***

Based on the availability of limited funds, the Company has prioritized the development of a novel anti-cancer drug and is currently focusing on developing novel therapeutic agents that could be used as adjuvant chemotherapeutic agents to treat aggressive metastatic, invasive and drug resistant tumors. The Company's lead compound has shown very promising results in pre-clinical animal models for the treatment of metastatic and hormone refractory prostate cancer as well as metastatic melanoma. Subject to the completion of a round of financing in a timely fashion, the Company plans to complete the pre-clinical studies in 2011 and file an IND application in 2012 to initiate human clinical studies in North America. The Company expects that it will cost approximately \$2,000,000 to complete the various pre-clinical studies.

### ***Therapeutic Agent for treatment of Alzheimer's Disease***

The Company is developing of a novel therapeutic agent for the treatment of Alzheimer's disease (AD) and is at the proof of concept in-vivo stage. The efficacy of the lead molecule will be evaluated using the most suitable animal model and a promising drug candidate will be taken into pre-clinical and clinical development. The Company needs additional capital to pursue the development of its AD therapeutic agent. In October 2008, the Company has secured a funding of \$247,106 US from the Institute for Study of Aging (ISOA) to advance the pre-clinical development of its AD drug. Upon successful demonstration of proof of principle in-vivo and the completion of financing in a timely fashion, it plans to complete GLP non-clinical toxicology and safety pharmacology studies in 2012 and plans to file an IND application in 2013 to initiate Phase-I trials in the US. The Company expects that it will cost approximately \$2,500,000 to demonstrate proof of validation in-vivo, lead optimization and to complete the various pre-clinical studies required for IND filing.

## Results

For the three month period ended March 31, 2010, the Company had a net loss of \$105,210 or \$0.0030 per diluted share as compared to a net loss of \$133,744 or \$0.0038 per diluted share for the same period of the previous year. As indicated above, the decrease in the net loss mainly resulted from decreases in research and development costs, professional and consulting fees and stock option compensation. The Company expects to continue to incur losses as it continues its research and development programs.

## Working Capital

As at March 31 2010, the Company had cash and cash equivalents, receivables, investment tax credits receivable and prepaid expenses in the aggregate amount of \$416,686 and accounts payable and accrued liabilities of \$205,992 resulting in a working capital of \$210,694 compared to a working capital of \$314,044 as at December 31, 2009.

On October 21, 2008, the Company announced that it received funding from the Institute for Study of Aging (ISOA) in the form of a recoverable grant of up to \$247,106 US Dollars to develop a novel class of drugs for Alzheimer's disease. "ISOA" is a private foundation established by the Estee Lauder family in 1998. Under the terms of the refundable grant, all funds granted, and any interest or earnings earned thereon, until expended for the purposes of the project, shall not be used for any other purpose and shall not be invested in any manner that would jeopardize or impair their availability either for the use by the Company for the purpose of the project or for the return to "ISOA". Such funds shall not serve as security for any indebtedness of the Company for any money borrowed, loaned or guaranteed. Any portion of the funds not used for the purposes of the project shall be repaid to "ISOA".

As at March 31, 2010, the Company had received \$177,375 CDN Dollars (\$150,000 US Dollars). The balance of \$97,106 US is to be issued upon ISOA's receipt of a report indicating that the original funds have been expended. As at March 31, 2010, approximately \$43,440 of the working capital is restricted for the use of the research project for which the "ISOA" grant was issued.

Under the terms of the grant agreement with ISOA, title to any discoveries, inventions, developments, data and substances made, conceived or reduced to practice by the Company, its employees, contractors or agents during the performance of the research project or as a result of the project, including any patents, patent applications, copyrights and applications and registrations thereof, and all other intellectual property rights, title and ownership interest relating thereto will vest in the Company.

The prepaid expenses of \$36,979 (December 31, 2009 - \$911) includes \$34,780 of prepaid legal fees for costs resulting from the private placement which closed on April 1, 2010.

The decrease in working capital is due to the Company's on going research and development programs. Investment revenue has declined not only due to the reduced cash available for

investment, but also due to the decrease in the interest rates paid by financial institutions. In addition, following the trend in the economic slowdown in the economy, until the closing of the private placement which took place on April 1, 2010, the Company had not successfully completed any additional financing arrangements during the quarter. As announced on April 6, 2010 and disclosed in Note 13 to the consolidated unaudited interim financial statements for the quarter, this private placement generated gross proceeds of \$504,000 (before commissions of \$35,280 and legal fees estimated at \$50,000).

## **Capital Resources**

The Company will need to raise additional capital in the near term. As the research and development activities increase, it is anticipated that the Company's capital requirements will also increase proportionately. At present, the Company is looking to raise additional capital through the issuance of equity. In order to manage the developmental activities with the current cash at hand, the Company has prioritized its research and development activities on the development of a novel therapeutic agent for Alzheimer's disease (AD) as well as a novel therapeutic agent for cancer. The Company's research and development programs related to the development of a novel diagnostic test for Alzheimer's disease, a novel therapeutic product for osteoporosis and a novel therapeutic product for the treatment of rickets are currently a lower priority at present till further financing is secured. The Company has halted the development of novel therapeutics for osteoarthritis and aging, which may be reactivated at a later stage once further financing has been secured and the products specifically related to Alzheimer's disease and cancer have been advanced significantly. It is estimated that the Company will require approximately \$5 million in additional capital over the next two years to continue the development of the various products described above. However, there can not be any guarantee that the Company will be able to successfully raise the required capital to continue its operations or to be able to complete the various research & development milestones in a timely fashion. The Company's working capital requirements and its ability to raise additional capital are dependent on various factors, including, but not limited to, market conditions, obtaining satisfactory pre-clinical and clinical data, successfully entering into collaborations and partnerships for product development, regulatory approvals and commercialization, successfully filing patent applications and obtaining issued patents, maintaining, enforcing and defending patent claims, in-license outside patents as potentially needed, favorable outcome of regulatory review processes in a timely fashion and other factors that may be beyond the control of Management.

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders;
- to maintain sufficient cash resources to support its ongoing research activities;
- to maintain a flexible capital structure which optimizes the cost of capital at an acceptable level of risk.

In the management of capital, the Company includes, convertible debt and shareholders' equity comprised of share capital, warrants in the equity portion of the convertible debentures, stock options, warrants, contributed surplus and deficit in the definition of capital.

The Company manages its capital structure and makes adjustments to it in light of economic conditions and the risk characteristics of the underlying assets. The Company, upon the approval of the Board of Directors, will balance its overall capital structure through the issue of new shares, the issue of new debt, acquiring or disposing of assets, or by undertaking other activities as deemed appropriate under specific circumstances.

The Company has an externally imposed capital requirement related to their issue of the convertible note payable as disclosed in Note 7 to the consolidated interim unaudited financial statements. The Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2009.

### **Liquidity**

As at May 27, 2010, the Company expects that its current capital resources will be sufficient to carry on its overall research and development plans and general operations to July 31, 2011. The ISOA grant funds which is restricted to fund the Alzheimer's research provides the funding for the contract with the PBRC and other related expenses. The contract with PBRC is scheduled to run into December, 2010 and is being funded entirely by the ISOA grant received by the Company.

The Company will need to obtain new funds in the very near term to continue to pursue its operations. The Company is seeking different strategic alternatives to fund its operations and in spite of the Company's success in obtaining new funds in the past, there is no guarantee of success for the future.

### **RELATED PARTY TRANSACTIONS**

During the period ended March 31, 2010, the Company paid a total of approximately \$9,000 (March 31, 2009 - \$9,000) to two officers of the Company for consulting services rendered. These services were incurred 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.

### **SUBSEQUENT EVENTS**

On April 6, 2010, the Company announced that on April 1, 2010, completed a private placement in the amount of \$504,000 by issuing a total of 8,400,000 units at a price of \$0.06 per unit. Each unit consists of one common share of Osta Biotechnologies Inc. and one half common share purchase warrant. Each whole common share warrant entitles the holder to purchase one additional common share at a price of \$0.10 per share until April 1, 2012. As compensation, the Agents were paid a commission of \$35,280 and were granted non-transferable broker warrants allowing them to purchase 588,000 common shares of the Corporation at a price of \$0.10 per

share until April 1, 2012. The estimated fair value of the broker warrants of \$30,278 was calculated using the Black-Scholes option pricing method and will be recorded as part of share issue costs.

The securities issued in connection with the private placement are subject to a four-month hold period, expiring on August 2, 2010, in compliance with the policies of the TSX Venture Exchange and applicable securities legislation. As a result of the closing of the private placement, Osta has 43,786,528 issued and outstanding common shares. The securities issued in connection with the private placement will be subject to a four-month hold period under the policies of the TSX Venture Exchange and applicable securities legislation.

On May 3, 2010, options to acquire an aggregate 850,000 common shares at an exercise price of \$0.35 per share expired.

## **FINANCIAL INSTRUMENTS**

The Company's financial instruments are comprised of cash and cash equivalents, receivables, accounts payable and accrued liabilities and convertible debt.

### *Fair Value*

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

The Company has determined that the convertible debt contains multiple embedded derivatives. The first embedded derivative is a foreign exchange contract which management has determined is not closely related to the host contract, and as such, must be treated separately. The second embedded derivative is the embedded conversion option which requires management to make certain assumptions concerning the market interest rate for a non-convertible debt with similar terms and features. Management has determined that it is unable to measure both the fair value of the embedded foreign exchange contract, as well as determine an appropriate market interest rate in order to bifurcate the debt. As such the entire contract is therefore being treated as a financial liability held for trading. Management has determined that due to the nature of the convertible debt instrument, the Company's inability to obtain any other source of financing and the current financial position of the Company, that it would not be possible to make any meaningful determination of a market interest rate for a non-convertible debt instrument.

### *Credit risk*

The Company is exposed to credit risk through its cash and its cash equivalents. Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Cash and cash equivalents are maintained with a high quality financial institution. The carrying amount of cash and cash equivalents represents the Company's maximum credit exposure.

### *Interest rate risk*

The Company manages its portfolio investments based on its cash flow needs and with a view to optimizing its interest income. A change in the interest rates of 1% will not have a significant impact on the operations and cash flows of the Company.

#### *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 its liquidity risk by continuously monitoring cash flows and through the regular distribution of this information to the Board of Directors and the Audit Committee.

## **OUTLOOK**

At present the Company is a research and development company that has yet to generate any revenues. The Company is expected to continue to incur operating losses as it continues with the research and development of various products. The Company is currently focusing on the completion of currently on-going pre-clinical studies for the development of a novel therapeutic agent for Alzheimer's disease (AD) and pending successful completion of these studies and a successful completion of financing, the Company plans to complete the required pre-clinical toxicology and safety pharmacology studies to support the filing of an IND application to initiate human clinical trials. In addition, the Company is continuing the development of a novel therapeutic agent for cancer and expects to initiate pre-clinical toxicology and safety pharmacology studies required for IND filing as soon as it has successfully raised funds required for these studies. The Company is looking to raise additional capital by way of equity financings in order to continue the development of its products and it is anticipated that the total expenses will increase during fiscal 2010 should the Company successfully complete such additional financings.

## **MANAGEMENTS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management, including the President, Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators) as of December 31, 2009.

Management has concluded that, as of March 31, 2010, the Company's disclosure controls and procedures were effective to provide reasonable assurance that material information relating to the Company would be made known to them by others within the Company and its subsidiaries, particularly during the period in which this report was being prepared.

Management is responsible for and has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. There were no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.