

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Unless stated otherwise, dollar amounts are in Canadian dollars)

October 16, 2009

This review contains management's discussion of Cangene Corporation's operating results and financial condition for the year ended July 31, 2009, and should be read in conjunction with the 2009 audited annual consolidated financial statements and associated notes.

The discussion of products in this report is intended as an information summary for investment purposes and does not contain all relevant product safety and risk information. Healthcare professionals should refer to approved labelling or the appropriate prescribing information for products and not rely on information discussed in this report. Prescribing information or drug names may differ in various countries. Scientific information that relates to unapproved products or unapproved uses of products is preliminary and investigative. No conclusions can or should be drawn regarding the safety or efficacy of such products. Only regulatory authorities can determine whether products are safe and effective for the uses being investigated. No information in this report is intended to promote the products discussed.

Disclosure and internal controls

Management has established and maintains disclosure controls and procedures in order to provide reasonable assurance that material information relating to Cangene Corporation is made known to us in a timely manner, particularly during the period in which the annual filings are being prepared. We have evaluated the effectiveness of our disclosure controls and procedures as at the date of this report, and believe them to be effective in providing such reasonable assurance.

Management is also responsible for the design and effectiveness of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles ("GAAP"). We do not expect that our internal control over financial reporting will prevent or detect all misstatements due to error or fraud. Because of the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute assurance, that all control issues and instances of fraud or error, if any, within the Corporation have been detected. The Corporation is continually evolving and enhancing its systems of internal controls over financial reporting. We have evaluated the design and effectiveness of our internal control over financial reporting as at the end of the period covered by the annual filings and have concluded that, subject to the inherent limitations noted above, the controls are sufficient to provide reasonable assurance.

Forward-looking statements

Management's discussion and analysis contains certain forward-looking statements that are predictive in nature and subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted in this discussion. These risks and uncertainties include, but are not limited to, those discussed in the Risks and Uncertainties section within this MD&A. Forward-looking statements may include words such as "expects", "plans", "will", "believes", "estimates", "intends", "may", "bodes" or other words of similar meaning (including negative and grammatical variations) and may relate to future financial performance, business strategies, or safety and efficacy of unapproved products. Should known or unknown risks or uncertainties materialize, or should our assumptions prove inaccurate, actual results could vary materially from those anticipated. We are under no obligation to update any forward-looking statements, except as required by applicable law.

Non-GAAP financial measures

Management's discussion and analysis may contain non-GAAP financial measures. Terms by which non-GAAP financial measures are identified include, but are not limited to, "net cash", "total assets", "sales", "EBITDA" or other similar expressions. Non-GAAP financial measures are used to provide management and investors with additional measures of performance. However, non-GAAP financial measures do not have standard meanings prescribed by GAAP and are not directly comparable to similar measures used by other companies.

Overview

Cangene Corporation ("Cangene", "the Company", "the Corporation", "we" or "our") is a biopharmaceutical company in the business of developing, manufacturing, and commercializing products and technologies for global markets. We manage our business and evaluate performance based on two operating segments: biopharmaceutical operations and contract services. Revenues are generated from product sales, contract-manufacturing and contract-R&D services, and royalties. International sales are transacted mainly in U.S. dollars, as is customary in the industry.

Cangene has a majority shareholder, the Apotex Group ("Apotex"), which, to the knowledge of the directors of Cangene, at October 16, 2009 controlled, directly or indirectly, 42,875,787 common shares, representing 62% of the outstanding common shares of Cangene. The Apotex Group includes Apotex Holdings Inc., Apotex Inc. (a leader in the Canadian generic drug industry), Apotex Research Inc., and Apotex Corp., as well as the charitable foundations, Sherman Foundation and Apotex Foundation. The Apotex Group is

controlled, directly or indirectly, by Bernard Sherman and the Bernard and Honey Sherman Family Trust, of which he is the trustee. Dr. Sherman is also Chairman, Chief Executive Officer and a director of Apotex Inc., and is President and a director of Sherman Foundation and Apotex Foundation.

Strategically Cangene is focused primarily on therapeutics for infectious diseases and biodefence applications. We have particular development and manufacturing expertise with two main types of products:

- hyperimmunes, which are concentrated specialty antibody preparations made from plasma, and
- recombinant biopharmaceuticals, which are therapeutic proteins made by introducing a particular gene into a host organism, which in turn produces the protein of interest.

We have expertise in manufacturing technologically complex and sterile injectable products, and also offer contract R&D and manufacturing services to other biopharmaceutical companies and government organizations. In addition, we have an ongoing innovative R&D program, providing further opportunities for long-term growth.

Our first approved product was WinRho® [Rh₀ (D) Immune Globulin (Human) for Injection], and its development established a core competency in developing and manufacturing hyperimmunes. Three additional hyperimmune products, VariZIG™ [Varicella Zoster Immune Globulin (Human)], VIG [Vaccinia Immune Globulin Intravenous (Human)] and HepaGam B® [Hepatitis B Immune Globulin (Human) Injection] have also been approved for use.

We also have a recombinant biopharmaceutical development program. Since 1995, under an existing agreement, Apotex funded research and development of several of our recombinant products. These funding obligations have now been satisfied and we have signed a new agreement with Apotex (see New Developments). Our first licensed recombinant product is Accretropin™ ([somatropin (rDNA origin)] Injection), our human growth hormone, which has been approved by the U.S. Food and Drug Administration ("FDA"). While we are continuing to develop certain products, such as recombinant monoclonal antibodies, in our independent R&D program, under the new agreement this development is not being funded by Apotex.

Revenues from the biopharmaceutical-operations segment result largely from sales of WinRho® SDF, which are made primarily through our distributor, Baxter Healthcare Corporation. HepaGam B®, our next largest commercial product, continues to grow in both sales and market share in the North American market.

We have leveraged our capability to develop and manufacture hyperimmunes into a contract-services business, and we have been awarded several contracts to develop and manufacture certain biodefence products for the U.S. government. The first of these was a contract with the U.S. Centers for Disease Control and Prevention ("CDC") to develop and manufacture VIG, a product used to treat certain complications associated with smallpox vaccination. Revenue from this contract peaked in fiscal 2003 and the product was subsequently approved by the FDA in May 2005. During fiscal 2006, we were awarded significant stockpiling contracts by the U.S. Department of Health and Human Services ("HHS") to develop and supply immune globulins aimed at botulism toxins (heptavalent Botulism Antitoxin, "BAT") and inhalational anthrax (Anthrax Immune Globulin, "AIG") under the U.S. Project BioShield initiative. These contracts are managed by the Biomedical Advanced Research and Development Authority ("BARDA") within HHS. The base contracts for BAT and AIG have a combined revenue value of approximately US\$505 million. Early in fiscal 2008, we met the product requirements as defined by both the BAT and AIG contracts that permitted us to begin shipping product. Subsequent delivery and acceptance into the U.S. Strategic National Stockpile ("SNS") of both products allowed us to invoice for these initial shipments. Revenue recognized on these contracts, including product costs and reimbursable development costs incurred to date, amounted to \$147.1 million in 2009.

Our specialized facilities in Winnipeg, Manitoba, Canada and our manufacturing experience allow us to offer contract services for a broad range of technologically complex, process-sensitive compounds in addition to hyperimmunes. Our Chesapeake Biological Laboratories, Inc. ("Chesapeake") subsidiary in Baltimore, Maryland, United States, offers facilities for filling and finishing process-sensitive biologics.

Our contract-services segment continues to contribute significant revenues to our overall business; however, this segment is subject to large fluctuations in activity and revenue due to timing of contract deliveries. We are pursuing new contract R&D and manufacturing opportunities, including further contract opportunities with the U.S. and other governments. We also seek contract R&D and manufacturing agreements with biopharmaceutical industry partners, particularly at the Chesapeake operation.

We will use cash generated from operations to increase investment in independent research and development, ranging from expanding applications of hyperimmunes to innovative research into entirely new therapies with a primary focus on infectious disease.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Outlook

Our primary focus continues to be meeting delivery commitments on the U.S. government BAT and AIG contracts. We made substantial deliveries on both contracts during fiscal 2009. Our plasma inventory levels continue to be ahead of schedule and we anticipate that we will be successful in meeting our current delivery requirements. For both products we will continue deliveries as specified under the contracts unless otherwise directed by BARDA. We are also continuing to work on the licensing elements of the contracts for both products and those efforts are expected to continue.

Strategically, we have also focused on increasing our plasma collection capabilities through expansion of our existing plasma centres. The expansions are largely complete and operations in the expanded centres are being phased in. These efforts are aimed at bringing more of our plasma supply in-house. Competition for plasma supplies and donor recruitment are significant risks for us with respect to most of our hyperimmune products (see Risks and Uncertainties) and we are looking to reduce this risk by becoming increasingly self-sufficient in plasma supply. In addition, in-house supply of plasma can be more cost-effective than commercial purchases. We are currently in the process of re-branding the centres under the name Cangene Plasma Resources so they are more closely identified with our corporate identity. In addition, we are considering adding new sites in the United States.

With respect to WinRho[®] SDF, we have withdrawn our Marketing Authorization Applications ("MAA") that were underway in 16 European Union ("EU") countries and will also cease marketing the product in the EU countries where Marketing Authorizations had already been obtained. The decision to exit the EU market was based on the challenges and cost of obtaining regulatory approval in the remaining 16 EU countries, as well as a re-evaluation of the market potential, where several products are approved to treat the same indications. The focus will now be on markets where we can effectively compete and on growing the North American market share.

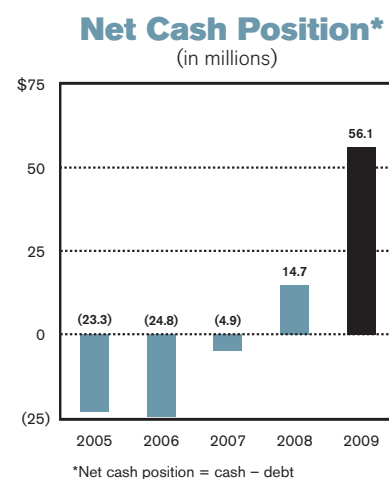
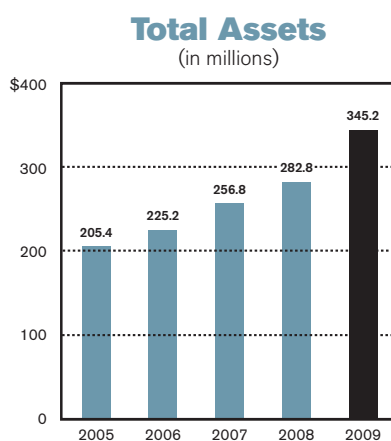
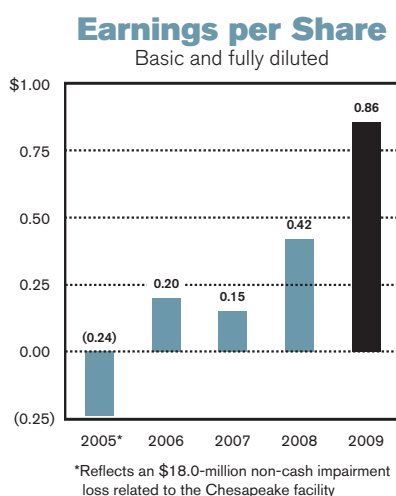
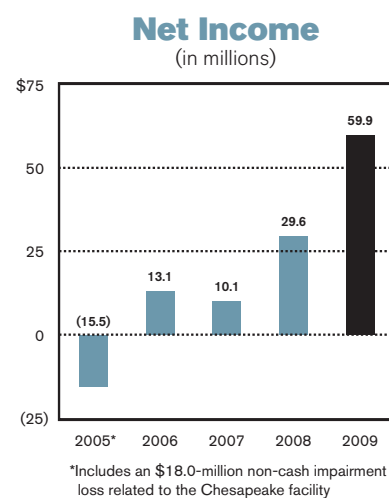
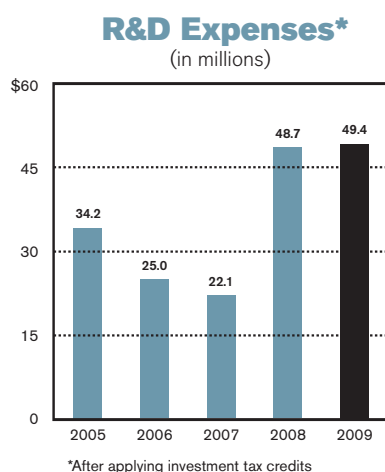
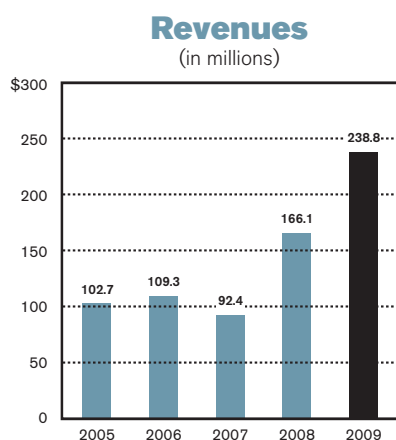
We continue to grow HepaGam B[®] sales in the U.S. and Canada, targeting the largest liver transplant centres as well as the long-term post-transplant (home therapy) market to introduce them to the product. The FDA has granted HepaGam B[®] orphan drug status, which confers seven years of market exclusivity for the approved indication to prevent hepatitis B recurrence following liver transplantation. With this market exclusivity and as the first hepatitis B immune globulin licensed by the FDA for this indication, we believe that HepaGam B[®] will provide strong sales in the years to come as we continue to penetrate the U.S. market.

We have entered into an agreement with Maxygen, Inc. for an exclusive option to acquire an exclusive licence to Maxygen's protein therapeutic called MAXY-G34 for treating acute radiation syndrome ("ARS"). Cangene paid an upfront fee of US\$0.5 million for this option. This protein is a long-acting version of the white-blood-cell-stimulating protein known as G-CSF. We concurrently submitted a bid to develop MAXY-G34 for treating ARS under a request for proposal ("RFP") issued in March 2009 by BARDA. If we are awarded a development contract under this RFP that meets our criteria, we would exercise our option with Maxygen and pay licence fees.

Looking toward 2010, we are continuing to focus our efforts on a number of independent research and development initiatives, including hyperimmune process improvements, clinical studies, and the development of monoclonal antibody technology and other anti-infectives. We also continue to evaluate a number of acquisition, licensing and distribution opportunities with respect to companies and specific products. We are well on our way to achieving our goal of introducing eight new products by 2016.

Selected Annual Information

The summarized information in the following charts is taken from our Canadian GAAP consolidated financial statements and reported in Canadian dollars. A significant portion of our revenues are in U.S. dollars and we have significant operations in the U.S., requiring translation of these revenues and operations to Canadian dollars. Net cash is not a defined term under Canadian GAAP and it should not be construed as an alternative to using the balance sheet as a measure of our financial position. Readers are cautioned that our method of calculating net cash may not be comparable to similar measures presented by other issuers.



Revenue fluctuations within the contract-services segment, coupled with increased research and development activities aimed at expanding our product pipeline, have contributed to fluctuations in profitability over the last five years. In 2006, contract-research activities in the biodefense product pipeline declined as CDC research agreements were completed and we prepared to embark on supply contracts with HHS. However, approved product sales in 2006 increased as a result of a significant international sale of VIG and improved WinRho® SDF sales. In 2007, our net income decreased due to the absence of a significant VIG sale and reduced revenues on earlier BAT and AIG R&D contracts, compounded by the fact that the BAT and AIG stockpiling contracts awarded in 2006 were not yet generating revenue. These factors were partially mitigated by improved WinRho® SDF sales, and improved margins and prices on the liquid formulation in the U.S.

In 2008, we reached significant milestones in both the BAT and AIG stockpiling contracts. The product deliveries and ongoing licensing and development work associated with these contracts contributed \$75.9 million in revenue in 2008, resulting in a substantial improvement in revenue over recent years. The large increase in research and development expenses in 2008 is also associated with the contracts. Some of this R&D activity took place in prior periods but was only able to be expensed when the associated contract revenues were earned in 2008 following achievement of contract milestones. In 2009, revenues on the BAT and AIG stockpiling contracts reached \$147.1 million, helping us achieve the highest revenue total in our history. Research and development expenses in 2009 were consistent with 2008 in total; although 2009 included a higher proportion of independent R&D activity.

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Net income has fluctuated over the last five years, largely as a result of varying levels of activity on biodefence contracts. The loss in 2005 was the result of the write-down of a specialized facility at Chesapeake. Earnings per share over the five-year period primarily reflects the fluctuations in earnings due to the changing activity on biodefence contracts. To a lesser extent, the increased number of shares outstanding that resulted from the share offering in fiscal 2007 and the exercise of stock options also lowered earnings per share. In 2008 and 2009 the number of shares outstanding decreased due to cancellations under our Normal Course Issuer Bids. Earnings per share in 2008 and 2009 are considerably improved over the previous three years, with 2009's outstanding results positioning us for the highest earnings per share in our history.

Over the last five years, we have also added significant strength to our financial position and our asset base has grown each year. While our net cash position had decreased to correspond with a major hyperimmune production-facility expansion and with the investment in inventories and contracts in progress associated with the stockpiling contracts, it increased as debt was repaid in 2007 and 2008, and as stockpiling contract revenues were received in 2008 and 2009. A large portion of our debt was repaid in 2007 with the proceeds of a share offering. As at July 31, 2008 and 2009, we had no debt outstanding. At July 31, 2009, we have significant cash balances, positioning us well to take advantage of future opportunities for growth, whether through marketing efforts, internal development of products and technologies, or acquisition activity.

New Developments

On September 19, 2008, we announced that we had submitted a centralized Marketing Authorization Application for HepaGam B[®] to the European Medicines Agency. Under the centralized procedure, the Marketing Authorization Application applies to the 30 European Economic Area countries.

On September 30, 2008, we received a contractual milestone payment of US\$3.0 million from Baxter, in recognition of Baxter achieving US\$150.0 million in cumulative worldwide net sales of WinRho[®] SDF under our distribution agreement. This revenue was recorded in the first quarter of fiscal 2009.

On January 23, 2009, we announced that an amendment to our Normal Course Issuer Bid (the "2008 Bid") had been approved by the Toronto Stock Exchange. The amendment increased the maximum number of our common shares available for purchase under this bid from 1,000,000 to 1,250,000, representing 1.8% of our outstanding common shares on April 22, 2008, that being the date of the related Notice of

Intention to Make a Normal Course Issuer Bid. The 2008 Bid expired on April 24, 2009.

On April 14, 2009, we announced that we had hired a new Vice President to replace John McMillan who retired last year. In his role as Vice President, Commercial Development, Paul Brisebois will focus on growing the commercial side of our business. He brings more than a decade of experience in sales and marketing related to the agri-food industry. He holds a BComm from the University of Saskatchewan and has graduated from Columbia University's Executive Marketing Management Program, Wharton's Competitive Marketing Strategy Program and the Queen's University Executive Development Leadership Program.

On April 15, 2009, we reported that the Chemical Biological Medical Systems Joint Project Management Office of the United States Department of Defense ("DoD") had signed an agreement to purchase our Vaccinia Immune Globulin Intravenous (Human) ("VIG"). The four-year, sole-source base contract is expected to generate approximately US\$4.9 million in revenue. We expect to deliver the product during fiscal 2010. The DoD has two options to purchase additional product during the course of the contract, which, if exercised, could add approximately US\$7 million in revenue to the total value.

Also on April 15, 2009, we announced that we had signed a new agreement with the Apotex Group. Since 1995, under an existing agreement, Apotex has funded research and development of several recombinant biopharmaceutical products at Cangene; these funding obligations have been satisfied. Under the new agreement, we obtained rights to commercialize these products, which include Leucotropin[®], our version of a white-blood-cell-stimulating protein known as GM-CSF, and Accretropin[™], our human growth hormone. Due to the extent of Apotex's investment in the two lead drugs, however, both companies have the right to take Leucotropin[®] or Accretropin[™] to market and would pay the other company a small royalty based on any sales. Also changed under the new agreement was the royalty revenue that we receive from Apotex on its sales of a product called Ferriprox[®] (deferiprone). This revenue will be phased out over three fiscal years—we received a royalty equivalent to 50% of the net profits on deferiprone's sales for 2009, and are entitled to receive 37.5% in 2010 and 18.75% in 2011. Our independent directors approved the new agreement after having determined that it is fair to Cangene and our shareholders.

On April 22, 2009, we announced that a new Normal Course Issuer Bid (the "2009 Bid") had been accepted by the Toronto Stock Exchange. During the course of the 2009 Bid, we intend to purchase for cancellation up to but not more than

1,000,000 of our common shares, representing 1.4% of the outstanding common shares on April 20, 2009. As at April 20, 2009, the total number of issued and outstanding common shares was 69,481,670. The average daily trading volume for the six months preceding April 20, 2009 was 50,372 common shares. Except for block purchases, the daily repurchase restriction during the course of the 2009 Bid is 12,593 common shares, that being 25% of the average daily trading volume. The 2009 Bid commenced on April 25, 2009 and will expire on April 24, 2010. Purchases will be made through the facilities of The Toronto Stock Exchange at prevailing market prices. Any of our common shares purchased under the 2009 Bid will be cancelled. Our Board of Directors believes that purchases under the 2009 Bid constitute a desirable use of funds on the basis that recent market prices of our common shares do not, and at certain times during the course of the 2009 Bid may not, fully reflect the value of our business and future business prospects. At July 31, 2009, we had purchased, in aggregate under the 2008 and 2009 Bids, 1,768,400 common shares at an average price per share of \$5.03 since the inception of the Bids.

On April 23, 2009, we reported that HepaGam B[®] had been approved by the Biologics and Genetic Therapies Directorate of Health Canada for treating acute exposure to hepatitis B virus (post-exposure prophylaxis or PEP). This is the second approved indication in Canada. HepaGam B[®] is a purified antibody or hyperimmune that is specific for hepatitis B virus. HepaGam B[®] is also approved by the U.S. Food and Drug Administration ("FDA") for this indication and for use in liver transplant recipients; HepaGam B[®] is the first hepatitis B immune globulin product to be approved for both these indications in North America.

On May 7, 2009, we announced that we had submitted a bid to develop a therapeutic for treating ARS under an RFP from BARDA and that we had signed an agreement with Maxygen, Inc. that gives us an exclusive option to acquire an exclusive licence to its MAXY-G34 product for use in treating ARS. See Outlook for details on these concurrent events.

On June 3, 2009, we received approval from the Israeli Ministry of Health for the use of HepaGam B[®] for its two indications: PEP and preventing re-infection in liver transplant recipients who are positive for hepatitis B infection. This is the first non-North American approval for this product.

On July 7, 2009, we announced that we had acquired all issued and outstanding shares of privately held Twinstrand Therapeutics Inc. ("Twinstrand"). We paid \$1.7 million for the acquisition (after post-closing adjustments), which includes

the products, technologies and financial attributes (including those related to tax) of Twinstrand. Twinstrand's technology uses modified versions of ricin, a plant-derived cell toxin, as therapeutic prodrugs. Its lead drug, a product known as TST10088, is currently undergoing a Phase I clinical trial. Prodrugs are compounds that leave healthy cells unaffected while specific chemical activity within targeted diseased cells activates the cell-killing activities of the drug. Twinstrand had also begun developing anti-ricin antibody-based therapeutics and Cangene has collaborated in the past on this technology.

On July 30, 2009, we announced that we were withdrawing our Marketing Authorization Applications with respect to WinRho[®] SDF that were underway in 16 EU countries and also ceasing marketing of the product in EU countries in which Marketing Authorizations had already been obtained. This decision was based on the challenges and costs of obtaining regulatory approval in the remaining 16 EU countries, as well as the re-evaluation of our marketing strategy and the current competitive landscape, where several products are approved to treat the same indications.

On September 22, 2009, we announced a \$3.3-million contract to supply VIG and BAT to a non-North American government. This is the first sale of our investigational BAT product to a customer other than the United States government.

On October 16, 2009, our Board of Directors approved a new agreement with Apotex, under which we acquire commercialization rights for HepaGam B[®]. The effective date for the transfer of rights is November 1, 2009 and we will pay Apotex an upfront fee of US\$7.0 million. Under the agreement, we will also pay royalties on net U.S. sales of HepaGam B[®] occurring prior to June 2016. Our independent directors approved this new agreement after having determined that it is fair to Cangene and our shareholders.

RESULTS OF OPERATIONS

Consolidated revenues

Total revenues for the year ended July 31, 2009 were \$238.8 million, compared with \$166.1 million in the prior year, an increase of 44%. Our revenues have increased dramatically in 2009, essentially due to the strength of our contract-services segment and the \$147.1 million in revenue from the BAT and AIG stockpiling contracts. By comparison, in 2008 we recognized \$75.9 million in revenue on the stockpiling contracts.

We manage our business and evaluate performance based on two operating segments: biopharmaceutical operations and contract services.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

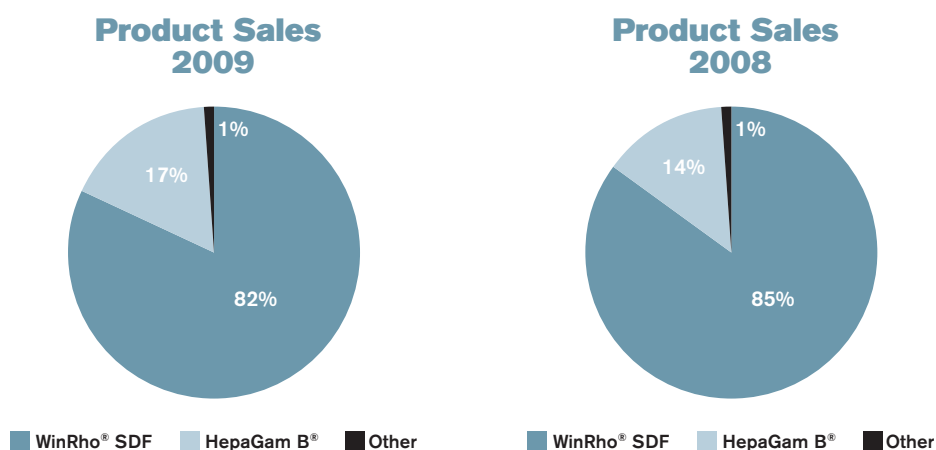
Biopharmaceutical operations

Product-sales revenues in the biopharmaceutical operations segment consist of sales of approved products. R&D-services revenues in this segment include revenue from joint development agreements with Apotex. Royalty revenues are received from Apotex based on its sales of a drug called Ferriprox® (deferiprone) that it manufactures and markets.

	2009				2008			
	Product sales	R&D services	Royalties	Total	Product sales	R&D services	Royalties	Total
Revenues	\$ 50,735	\$ 5,269	\$ 9,079	\$ 65,083	\$ 42,084	\$ 11,632	\$ 7,891	\$ 61,607
Gross profit	\$ 36,102	\$ 2,027	\$ 9,079	\$ 47,208	\$ 24,870	\$ 4,210	\$ 7,891	\$ 36,971
Gross margin	71%	38%	100%	73%	59%	36%	100%	60%

In the current year, our sales revenues for WinRho® SDF in the U.S. have increased by approximately 21%, while sales in Canada have increased by approximately 22%. European sales grew by 14%; however, we have recently opted to exit the European market with WinRho® SDF (see New Developments). The increased WinRho® SDF revenues in the U.S. included a US\$3.0-million contractual milestone payment from Baxter in the first quarter; removing the impact of this payment, our revenues for the U.S. market would have increased only slightly over 2008.

HepaGam B® sales have grown consistently throughout 2009, and were a combined \$8.5 million for the year in Canada and the U.S., an increase of 48% over its 2008 revenues. HepaGam B® has received orphan drug exclusive approval from the FDA for the prevention of hepatitis B recurrence following liver transplantation. This designation gives our product seven years of market exclusivity in the U.S.



Gross margin on product sales increased by 12% in 2009, as WinRho® SDF margins have improved due to the contractual milestone payment of US\$3.0 million received in 2009, as well as growth in sales of the higher margin liquid formulation and a decline in sales of the lower margin freeze-dried product. While this change in sales mix is the primary reason for the improved gross margin, during the year we implemented some price increases and have stopped selling into some of the markets where we were not realizing strong margins.

Our R&D-services revenues in 2009 have declined from 2008, as work on our joint development agreements with Apotex, including Accretropin™ and Leucotropin®, came to a close in 2009 (see New Developments on page 28 for information on our new agreement with Apotex). Gross margin on R&D-services activities in this segment for 2009 has remained consistent with 2008, although it can vary with the level of development activities on joint research projects with Apotex and with the eligibility of research expenditures to generate investment tax credits.

The increase in royalty revenue in the current year is due to higher sales of Ferriprox[®], the drug manufactured and marketed by Apotex, for which Cangene received 50% of net profits. See New Developments (page 28) for information on our new agreement with Apotex under which these royalty revenues will be phased out over the next two fiscal years.

Contract services

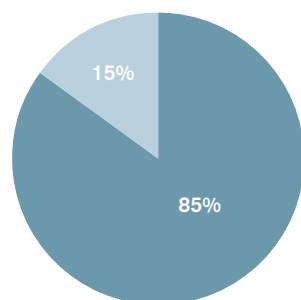
Product-services revenue in the contract-services segment comprises third-party contract-manufacturing revenues at Cangene's Winnipeg facilities as well as at Chesapeake. R&D-services revenues in this segment are derived from contract-R&D activities for third parties including government and non-government customers.

in thousands of Canadian dollars

	2009			2008		
	Product services	R&D services	Total	Product services	R&D services	Total
Revenues	\$ 127,055	\$ 46,613	\$ 173,668	\$ 44,302	\$ 60,147	\$ 104,449
Gross profit	\$ 59,559	\$ 13,158	\$ 72,717	\$ 15,845	\$ 24,897	\$ 40,742
Gross margin	47%	28%	42%	36%	41%	39%

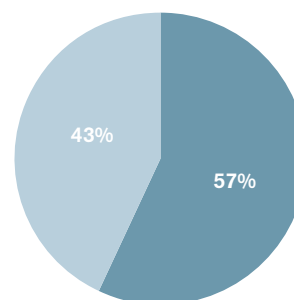
Our much higher product-services revenues in 2009 result from deliveries of product on the BAT and AIG stockpiling contracts. We delivered significant quantities of product to the SNS during 2009, resulting in product-services revenues of \$108.1 million. Our Chesapeake subsidiary in the U.S. generated revenues in 2009 that were consistent with its 2008 performance. While continuing to generate third-party contract-manufacturing revenues, Chesapeake also contributed significantly to our efforts on the BAT and AIG stockpiling contracts in a subcontractor capacity.

Product-services Revenues 2009



■ Government ■ Commercial

Product-services Revenues 2008



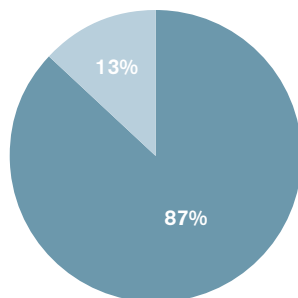
■ Government ■ Commercial

The gross profit on product-services revenues increased in absolute dollars due to the substantial growth in revenues, while gross margin also improved to 47% from 36% in the prior year. Our improved gross profit and gross margin on product-services revenues is due principally to activity on the BAT and AIG stockpiling contracts. During 2009 we delivered significant quantities of both products to the SNS.

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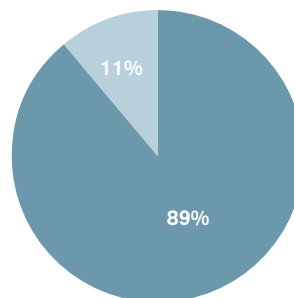
In R&D services, revenues in 2009 decreased because early in 2008 we recognized significant revenues related to the development and licensure components of the BAT and AIG stockpiling contracts with HHS when we reached certain contract milestones. While development activity related to these contracts continues, the revenues decreased year-over-year from \$51.6 million to \$39.4 million. We also continue to conduct other third-party contract-R&D work in our Canadian operations.

**R&D-services Revenues
2009**



■ Government ■ Commercial

**R&D-services Revenues
2008**



■ Government ■ Commercial

Gross profit on R&D-services revenues in this segment declined in comparison to the prior year. Our gross margin declined from the prior year as we realized lower margins on the fixed-price components of our BAT and AIG stockpiling contracts in 2009. However, we continue to perform well on fixed-price and cost-plus, fixed-fee elements of the BAT and AIG biodefence stockpiling contracts; some components of the work are eligible for scientific research and experimental development tax credits ("SR&ED"), which improves margins.

In addition to revenues and expenses recognized to date, we have also recorded costs in raw materials and work-in-process inventories related to the BAT and AIG stockpiling contracts. These costs can be expensed and the related revenue recognized when revenue recognition criteria are met. At July 31, 2009, we had recorded costs of \$62.0 million related to these two contracts as follows:

- Raw materials of \$22.1 million, Work in process – product costs of \$19.5 million, Work in process – manufacturing process development costs of \$4.6 million, Work in process – development costs of \$1.6 million and Finished goods of \$12.3 million recorded in Inventories and contracts in progress;
- Insurance of \$0.9 million recorded in Prepaid expenses; and
- Insurance of \$1.0 million recorded in Other assets.

We anticipate that contract-services revenues will continue to fluctuate in the future, depending on varying levels of activity

related to existing contracts and whether significant new R&D or manufacturing contracts with the U.S. government or other parties are awarded.

Independent R&D

Independent R&D expenses, from which no related revenue is derived, were \$12.7 million in fiscal 2009, compared with \$6.0 million in the prior year. Expenses increased as significant efforts were dedicated to HepaGam B[®], PEP 35, Leucotropin[®] and Ebola/Marburg, as well as an undisclosed anti-infective product. In 2008, the significant R&D expenses were related to hyperimmune process improvements, HepaGam B[®] studies and the PEP 35 project. We continue to conduct independent research in several related biopharmaceutical fields, ranging from expanding applications of hyperimmunes to innovative research into entirely new therapies.

Selling, general and administrative expense ("SG&A")

Total SG&A expense in 2009 increased to \$23.1 million from \$17.8 million in the prior year. Increased SG&A expense includes higher compensation costs, as well as higher consulting, licensing and director's fees, although these were partially offset by reduced regulatory filing fees. Increased compensation costs are largely a result of increased staffing to support work on the BAT and AIG stockpiling contracts, combined with compensation increases for merit and inflation.

Amortization

For the year ended July 31, 2009, amortization increased to \$13.0 million from \$12.4 million in the prior year.

Income taxes

Income tax expense of \$26.4 million for the year ended July 31, 2009 increased from \$12.0 million in the prior year due to the significant increase in taxable income. In addition, the effective tax rate in 2009 (32%) was higher than in 2008 (28%), primarily due to the recording in 2008 of previously unrecognized tax losses and timing differences relating to U.S. operations. The recognition of these tax losses and timing differences also contributed to the recovery of future tax. The effective tax rate in 2009 is not significantly different from the statutory rate as the benefit of the unrealized foreign exchange gain is almost entirely offset by the impact of the translation of the U.S. operations. The rate differential on foreign operations is included in the other items line.

Our income tax provision is determined as follows:

<i>in thousands of Canadian dollars</i>	2009	2008
Combined statutory federal and provincial tax rate at 32.1% [2008 – 34.8%]	\$ 27,733	\$ 14,480
Adjusted for:		
Recognition of previously unrecognized tax losses from prior years	—	(2,084)
Unrecognized temporary difference for unrealized foreign exchange loss on advances to U.S. subsidiaries	(1,666)	1,048
Reduction in tax rate on previously recorded tax losses	—	1,246
Recognition of previously unrecorded timing differences from prior years	—	(1,022)
Gain from bargain purchase	(1,115)	—
Non-taxable foreign exchange gain on translation of U.S. subsidiaries' monetary assets and liabilities	1,755	(884)
Effect of tax rate changes	(187)	(250)
Other	(74)	(552)
Income tax expense	\$ 26,446	\$ 11,982

We continue to record a valuation allowance against the U.S. future tax asset related to the impairment of the Chesapeake viral-vaccine-filling facility, which was determined to be impaired in 2005.

Net income

Net income for the year ended July 31, 2009 was \$59.9 million, compared with \$29.6 million for the prior year, an increase of 102%. The much higher net income in 2009 is primarily due to the higher revenue of \$147.1 million on the BAT and AIG stock-piling contracts in 2009 compared with \$75.9 million in the prior year. Our gross margin also improved in 2009, contributing to the improved net income. Partially offsetting our improved revenues and gross profit were higher independent R&D, and selling, general and administrative expenses, as well as increased tax expense. A significant foreign exchange gain in 2009 had a positive impact on net income.

Basic and diluted earnings per share

For the current year, our higher basic and diluted earnings per share reflect the effect of increased net income, as discussed above.

Summary of Quarterly Results

Quarters ended	July 31,	April 30,	January 31,	October 31,	July 31,	April 30,	January 31,	October 31,
<i>in thousands of Canadian dollars</i>	2009	2009	2009	2008	2008	2008	2008	2007
<i>except per-share data</i>	(Q4 2009)	(Q3 2009)	(Q2 2009)	(Q1 2009)	(Q4 2008)	(Q3 2008)	(Q2 2008)	(Q1 2008)
Revenues	\$84,638	\$67,346	\$34,543	\$52,224	\$63,114	\$29,650	\$23,467	\$49,825
R&D expense ¹	12,487	14,479	10,064	12,402	15,943	7,002	6,184	19,571
Net income	21,893	11,252	5,588	21,135	18,658	3,144	3,537	4,286
Earnings per share								
Basic	\$ 0.32	\$ 0.16	\$ 0.08	\$ 0.30	\$ 0.27	\$ 0.04	\$ 0.05	\$ 0.06
Diluted	\$ 0.32	\$ 0.16	\$ 0.08	\$ 0.30	\$ 0.27	\$ 0.04	\$ 0.05	\$ 0.06

1. Includes R&D expenditures, net of investment tax credits, classified as either cost of sales – R&D services or independent R&D.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *continued*

Revenues over the past eight quarters have fluctuated primarily in response to the timing of deliveries under manufacturing and R&D contracts.

The significant revenues in the first quarter of fiscal 2008 were due to the achievement of milestones on the BAT and AIG stockpiling contracts, which permitted us to both invoice and recognize revenue. In comparison, lower revenues in the following quarter reflected the fact that no product deliveries were made on the stockpiling contracts. Higher revenues in the third quarter of 2008 compared with the second quarter reflect a small AIG delivery and further development-related revenues on these stockpiling contracts, although these were partially offset by lower WinRho[®] SDF sales in the U.S. Net income in the third quarter of 2008 was adversely affected by a \$2.8-million expense associated with the withdrawal of one lot of VIG. Our revenues increased dramatically in the fourth quarter of 2008 compared with the first three quarters, due to delivery of a significant number of doses of BAT, a smaller AIG delivery, and ongoing licensure and development activities on the stockpiling contracts.

Revenues remained high in the first quarter of fiscal 2009 due to continued activity and further deliveries on the stockpiling contracts. Revenues declined in the second quarter of 2009 because no product deliveries were made under the BAT and AIG contracts during the quarter. The third quarter of 2009 includes revenue related to two BAT shipments and one AIG shipment. The fourth quarter of 2009 saw us reach the highest quarterly revenue in our history, primarily due to \$40.3 million in deliveries of BAT and \$16.3 million of deliveries of AIG in the quarter, combined with ongoing development work on the products.

R&D expense has fluctuated over the last two years with varying levels of activity on independent R&D, Apotex joint-development agreements and other third-party R&D contracts. Certain manufacturing-process-development costs that were incurred from 2007 to 2009 on the BAT and AIG contracts were capitalized in inventories and contracts in progress, and are expensed as product is delivered. As discussed earlier, acceptance of these products into the SNS occurred in the first quarter of fiscal 2008, triggering significant recognition of licensure and development costs that had previously been recorded in inventories and contracts in progress. And, similar to the first quarter, the fourth quarter of fiscal 2008 included significant R&D expenses associated with the stockpiling contracts. The second quarter of fiscal 2009 saw somewhat lower R&D expenses overall; however, it included a larger percentage of independent R&D expenses on Cangene products as compared to other recent quarters. The third and

fourth quarters of fiscal 2009 contain higher R&D expenses related to our independent research as well as the BAT and AIG stockpiling contracts.

Earnings per share over the two-year period reflects the fluctuations in net income as well as the recent decrease in the number of shares outstanding due to the Normal Course Issuer Bids, which have resulted in the purchase for cancellation of 1,768,400 of our common shares to July 31, 2009.

Liquidity & Capital Resources

Operating activities

Cash at July 31, 2009 was \$56.1 million, compared with \$14.7 million at the end of the 2008 fiscal year. Cash of \$60.6 million was provided by operating activities during 2009, compared with \$28.7 million during the prior year. The change was primarily due to the significant increase in net income during the current year. Net non-cash working capital balances and other assets related to operations has increased by \$9.5 million since July 31, 2008. Higher working capital levels at July 31, 2009 resulted mainly from increased inventories and contracts in progress, which primarily reflects plasma-collection activities, and work-in-process and finished-goods inventories for the BAT and AIG stockpiling contracts. Offsetting the impact of the increase in inventories and contracts in progress were reduced accounts receivable and other assets, and increased income and other taxes payable.

Financing activities

In 2009, cash of \$6.8 million was used in financing activities; all was related to the repurchase of shares for cancellation under our Normal Course Issuer Bids. In the prior year, \$6.6 million was used in financing activities, consisting primarily of \$2.7 million in repayment of long-term debt and \$2.1 million in repayment of bank indebtedness, combined with \$2.1 million in shares repurchased for cancellation under a Normal Course Issuer Bid.

Equity

The following table provides a continuity of the common shares issued and outstanding:

<i>in thousands of Canadian dollars</i>		
<i>except share-related data</i>	Number of shares	Share capital
As at July 31, 2007	70,409,470	\$ 66,894
Stock options exercised	95,700	450
Repurchase of shares for cancellation	(414,600)	(396)
As at July 31, 2008	70,090,570	66,948
Repurchase of shares for cancellation	(1,353,800)	(1,293)
As at July 31, 2009	68,736,770	\$ 65,655

At July 31, 2009, 2.4 million [July 31, 2008 – 1.8 million] options remained available to be granted under a stock option plan. Although we have not recently granted any stock options under the plan, it remains in effect until all outstanding options expire, or are exercised, forfeited or cancelled.

We anticipate that employees and directors will continue to exercise options in the future if exercise prices are less than the market price of the common shares.

A summary of the status of our stock option plan as at July 31, 2009 and 2008, and changes during the years ended on those dates is presented below:

	2009		2008	
	Number of options	Weighted- average exercise price	Number of options	Weighted- average exercise price
Stock options				
Outstanding at beginning of year	1,296,100	\$ 8.46	1,939,300	\$ 8.28
Exercised	—	—	(95,700)	4.70
Forfeited, expired and cancelled	(584,900)	6.65	(547,500)	8.48
Outstanding at end of year	711,200	\$ 9.96	1,296,100	\$ 8.46
Exercisable at end of year	711,200	\$ 9.96	1,295,475	\$ 8.46

The following table illustrates the number of common shares that would be outstanding, as at October 16, 2009, if all outstanding stock options were exercised.

	Exercise price	Number of securities outstanding	Weighted- average remaining contractual life	Number of options outstanding and exercisable	Number of common shares upon conversion or exercise ¹
Common shares		68,652,970			68,652,970
Stock options	\$ 9.31	341,300	0.5 years	341,300	341,300
	10.60	354,400	1.3	354,400	354,400
	9.33	5,000	2.8	5,000	5,000
	9.33	2,500	2.8	2,500	2,500
	\$ 8.68	2,500	3.8	2,500	2,500
Subtotal – Stock options		705,700	0.9 years	705,700	705,700
Total		69,358,670			69,358,670

1. Assuming exercise of all exercisable options whether in the money or not. Closing price for Cangene's common shares on the Toronto Stock Exchange on October 16, 2009 was \$4.49.

Debt

We have available a \$20.0-million operating line of credit with a bank. As at July 31, 2009 and 2008, there was \$Nil outstanding on the operating line.

The following table summarizes our contractual obligations:

<i>in thousands of Canadian dollars</i>	Total at July 31, 2009	Payments due by period			
		Less than 1 year	1–3 years	4–5 years	After 5 years
Operating leases	\$ 4,666	\$ 1,055	\$ 1,786	\$ 1,110	\$ 715
Purchase obligations ¹	9,343	6,049	2,295	999	—
Total contractual obligations	\$ 14,009	\$ 7,104	\$ 4,081	\$ 2,109	\$ 715

1. "Purchase obligation" means an agreement to purchase goods or services that is enforceable and legally binding on us and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Investing activities

Cash used in investing activities increased to \$14.4 million in 2009 from \$7.5 million in the prior year. Purchase of property, plant and equipment, net of tax credits, increased to \$12.7 million from \$7.5 million in the prior year, reflecting increased expenditures on plant and equipment as we continue to invest in expansion of plasma centre operations in addition to ongoing investments in software, equipment and manufacturing process control systems. We also increased the filling capacity at our Chesapeake facility in 2009. Other cash used in investing activities was related to our purchase of Twinstrand Therapeutics Inc. (see New Developments).

Liquidity & capital resources summary

Our ability to generate cash from operating activities, including product sales and contract services, as well as our ability to obtain debt financing from our bank, are expected to provide sufficient liquidity to meet anticipated needs of existing projects, including the U.S. government stockpiling contracts for BAT and AIG, absent the occurrence of any unforeseen events. We also anticipate that we could raise further new equity or obtain debt financing if and when new capital is required to fund growth and when a market opportunity exists.

Related-party Transactions

We have had agreements with Apotex to support the development of certain recombinant biopharmaceutical products. In addition, we receive royalties from Apotex on its sales of Ferriprox[®]. Effective April 13, 2009, we signed a new agreement with Apotex under which we acquire rights to the recombinant products, and royalties on Ferriprox[®] will change. See New Developments (page 28) for details about this new agreement with Apotex.

We also have had a distribution agreement with Apotex Corp. for it to market and distribute HepaGam B[®] in the U.S.; effective November 1, 2009, the distribution agreement will be terminated and a new agreement will come into effect whereby we obtain U.S. commercialization rights to HepaGam B[®] (see New Developments, page 29). We manufacture and hold the licence for the product.

Pursuant to the existing distribution agreement, in the year ended July 31, 2009, we earned revenues from Apotex of \$22.6 million, a decrease from the \$27.4 million earned during the prior year. At July 31, 2009, \$5.1 million was included in accounts receivable from these related-party transactions, compared with \$6.7 million at July 31, 2008. Related-party transactions are recorded at their exchange amount.

Critical Accounting Estimates

The preparation of financial statements that present fairly the financial position, financial condition and results of operations in accordance with Canadian GAAP requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the balance sheet date, and reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates. The following is a summary of critical accounting estimates and assumptions that we believe could materially impact our reported financial position, financial condition or results of operations.

Future benefit of deductible temporary differences

In accordance with *Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3465 – Income Taxes*, we should only recognize the future benefit of deductible temporary differences where it is more likely than not that sufficient future taxable income can be generated in order to fully utilize such losses and deductions. We are required to make significant estimates and assumptions regarding future revenues and earnings, and our ability to implement certain tax planning strategies in order to assess the likelihood of utilizing such losses and deductions. These estimates and assumptions are subject to significant uncertainty and if changed, could materially affect our assessment of the ability to fully realize the benefit of the future income tax assets. Future tax asset balances would be reduced and additional income tax expense recorded in the applicable accounting period in the event that circumstances change and, based on revised estimates and assumptions, we determined that it was no longer more likely than not that those future tax assets would be fully realized.

As at July 31, 2009, we have recorded a future tax asset of \$8.2 million, which comprises the benefit of non-capital loss carryforwards in the amount of \$2.7 million that resulted from the acquisition of Twinstrand Therapeutics Inc. (see New Developments) and the benefit of deductible SRED pools and inventory and other reserves in the amount of \$5.5 million. In addition, we have recorded \$4.5 million in other assets representing intercompany profits taxed at the legal entity level, but not yet realized on a consolidated basis. Unrecognized temporary differences relating to the impairment of the viral-vaccine-filling facility at our Chesapeake subsidiary, which was recorded in 2005, total \$18.0 million and have a potential future tax value of approximately \$6.2 million.

Goodwill valuation and impairment

In accordance with *CICA Handbook Section 3062 – Goodwill and Other Intangible Assets*, we have established a process for testing the valuation of goodwill on an annual basis for the

purposes of determining any potential impairment. In order to establish that the carrying value of net assets, including goodwill, for a particular business reporting unit exceeds the fair value, we are required to make significant estimates and assumptions regarding the timing and magnitude of future cash flows.

We acquired Chesapeake Biological Laboratories, Inc., a U.S.-based contract-manufacturing business, on January 31, 2001. At July 31, 2009, the book value of goodwill related to this acquisition was \$37.3 million. Chesapeake is an integral part of our contract-services segment.

We also acquired two U.S.-based plasma collection centres: Biotherapeutic Laboratories, Inc., on July 15, 1996 and Mid-Florida Biologicals, Inc., on July 11, 1997. At July 31, 2009, the book value of goodwill related to these acquisitions was \$3.2 million. The plasma centres are an integral part of our biopharmaceutical-operations segment.

When evaluating goodwill, we use estimates or forecasts of future cash flows for the next five years, plus estimates of residual cash flows beyond that time, which are discounted using an estimated discount rate that reflects our assumptions regarding the weighted-average cost of capital. Qualitative factors, including market presence and trends, strength of customer relationships, strength of local management, strength of debt and capital markets, and degree of variability in cash flows, as well as other factors, are considered when making assumptions with regard to future cash flows and the appropriate discount rate. We have not changed our approach or method of evaluating goodwill since we adopted this methodology. When evaluating the goodwill relating to the Chesapeake acquisition, we believe that our contract-manufacturing operations in Canada and the U.S. are essentially identical, and will work closely in tandem on certain current contracts and future contract opportunities; consequently, the goodwill is evaluated in the context of an aggregated contract-services segment. Similarly, the goodwill relating to the U.S. plasma centres is evaluated in the context of the aggregated biopharmaceutical-operations segment since these centres are integral to the supply of high-quality plasma for the manufacture and sale of hyperimmunes, which is currently the main source of revenue in this segment.

Goodwill impairment reduces the carrying value of goodwill on the balance sheets and is recorded as an expense. Goodwill impairment would typically be a non-cash expense since the valuation is performed on assets acquired and the related cash outflows from prior investments. Based on the evaluations, no goodwill impairment was recorded in 2009 or 2008. A change in any of the significant assumptions or estimates used to evaluate goodwill could result in a material change to the results of operations.

Impairment of long-lived assets

In accordance with *CICA Handbook Section 3063 – Impairment of Long-lived Assets*, we evaluate our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of a long-lived asset may not be recoverable.

We have considered whether or not any events or changes in circumstances have occurred in fiscal 2009 that would indicate that the carrying value of any of our remaining long-lived assets may not be recoverable, and have concluded that there is no indication of potential impairment to such assets.

Impairment relating to long-lived assets reduces the carrying value of the asset recorded on the balance sheets and results in an expense. A further change in any of the critical assumptions or estimates used to value the remaining long-lived assets could result in a material change to the results of operations.

Revenue recognition – biopharmaceutical product sales

In accordance with our revenue recognition policy, we recognize revenue from product sales, net of trade discounts, chargebacks, rebates and other allowances, when persuasive evidence of an agreement exists, delivery has occurred, price is fixed or determinable, and ultimate collection is reasonably assured.

We have agreements with distributors for marketing and distributing our WinRho[®] SDF, HepaGam B[®] and VariZIG[™] products. We recognize our share of the revenue from sales of these products by the distributors upon shipment by the distributors from their warehouses to wholesalers or customers.

Our distributors estimate allowances for revenue dilution items using a combination of information received from third parties, including market data, inventory reports from major wholesalers, historical information and analyses that they perform. Their estimates are subject to the inherent limitations of estimates that rely on third-party data, as certain third-party information may itself rely on estimates and reflect other limitations. Provisions for estimated rebates, and other allowances such as discounts, and promotional and other credits are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and contract terms, and actual discounts offered. We believe that such provisions are determinable due to the limited number of assumptions involved and the consistency of historical experience.

The provision for chargebacks is a significant and complex estimate used in the recognition of revenue and is calculated by the distributors. Our distributors market products directly to

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

wholesalers, and indirectly to group-purchasing organizations, physician practice-management groups and hospitals, collectively referred to as "indirect customers". The distributors enter into agreements with indirect customers to establish contract pricing for products. The indirect customers then purchase the products from wholesalers at these contracted prices. Under this arrangement, our distributors provide credit to the wholesaler for any difference between the contracted price with the indirect party and the wholesaler's invoice price. Such credit is called a chargeback. The distributors estimate the provision for chargebacks based upon historical chargeback experience and estimated wholesaler inventory levels, as well as expected sell-through levels by their wholesale customers to indirect customers. Their estimates of inventory at the wholesale customers and in the distribution channels are subject to the inherent limitations of estimates that rely on third-party data. We receive regular reports from distributors, and continually assess the reasonability of chargebacks and evaluate the estimates as new information becomes available. Adjustments to these provisions are made periodically to reflect new facts and circumstances that may indicate that historical experience may not be indicative of current and/or future results. In consultation with our distributors, we make subjective judgments based primarily on our evaluation of current market conditions and trade inventory levels related to the products. This evaluation may result in an increase or decrease in the experience rate that is applied to current and future sales, or as an adjustment to past sales, or both.

Accounting Changes, Including Initial Adoption of Accounting Policies

The preparation of financial statements that are fairly presented in accordance with Canadian GAAP requires that we adopt, select and apply appropriate accounting policies and principles, particularly where alternatives exist within GAAP.

Initial adoption of accounting policies

During the first quarter of fiscal 2009 we initially adopted the following new *CICA Handbook* standards:

CICA 1535 – Capital Disclosures:

This Section addresses disclosure of a company's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

CICA 3031 – Inventories:

This Section replaces *CICA 3030* and prescribes the accounting treatment for inventory. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. This Section impacted our standard costing and valuation of inventory through the determination of normal capacity in the creation of standards.

The adoption of this standard has had no material impact on our financial position or results of operations.

CICA 3862 – Financial Instruments – Disclosures:

This Section prescribes the required disclosure of financial instruments in financial statements.

CICA 3863 – Financial Instruments – Presentation:

This Section prescribes the required presentation of financial instruments in financial statements.

Sections 3862 and 3863 replaced *CICA 3861 – Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new Sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

CICA 1582 – Business Combinations:

This Section further aligns Canadian GAAP with U.S. GAAP and International Financial Reporting Standards ("IFRS"), and changes the accounting for business combinations in a number of areas. It establishes principles and requirements governing how an acquiring company recognizes and measures in its financial statements identifiable assets acquired, liabilities assumed, any non-controlling interest in the acquiree, and goodwill acquired. The Section also establishes disclosure requirements. This standard applies prospectively to business combinations for which the acquisition date is on or after the date of adoption. We have prospectively adopted this standard, which impacted the accounting treatment for the acquisition of Twinstrand Therapeutics Inc. (see New Developments) and resulted in the recognition of the gain from bargain purchase.

CICA 1601 – Consolidated Financial Statements and CICA 1602 – Non-controlling Interests:

These Sections further align Canadian GAAP with U.S. GAAP and IFRS. Sections 1601 and 1602 change the accounting and reporting of ownership interests in subsidiaries held by parties other than the parent. Non-controlling interests are to be presented in the consolidated statement of financial position within equity but separate from the parent's equity. The amount of consolidated net income attributable to the parent and to the non-controlling interest is to be clearly identified and presented on the face of the consolidated statements of income. In addition, these pronouncements establish standards for a change in a parent's ownership interest in a subsidiary and the valuation of retained, non-controlling equity investments when a subsidiary is deconsolidated. They also establish reporting requirements for providing sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. We have prospectively adopted these two standards; this adoption had no impact on our consolidated financial statements.

During the second quarter of fiscal 2009, we initially adopted the new *CICA Emerging Issues Committee ("EIC") 173 – Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, which became effective for our interim period ended January 31, 2009 with retrospective application without restatement of prior periods. The guidance requires that an entity's own credit risk and the credit risk of a counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. We have reviewed the guidance and applied it to derivatives recognized at fair values in the consolidated financial statements and determined that there was no impact.

Recent accounting pronouncement

The following new Handbook section is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008, and will be adopted by Cangene in fiscal 2010.

CICA 3064 – Goodwill and Intangible Assets:

This Section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. It revises the requirement for recognition, measurement, presentation and disclosure of intangible assets. We do not believe that Section 3064 will have a significant impact on our consolidated financial statements under current operating conditions. The only anticipated change is a modification of our accounting policy for patent costs. Prior to the adoption of *CICA 3064*, the Company expensed the majority of patent costs incurred. With the adoption of *CICA 3064*, patent costs that meet the applicable criteria in Section 3064 can be capitalized and amortized over their estimated useful lives.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that IFRS will replace Canadian GAAP for publicly accountable enterprises for fiscal years beginning on and after January 1, 2011, which for Cangene will be August 1, 2011. As a result of this announcement, we are planning and preparing for the coming changes in financial reporting requirements.

IFRS are based upon a conceptual framework similar to Canadian GAAP; however, significant differences exist in certain areas of recognition, measurement and disclosure.

We have commenced the process of transitioning from Canadian GAAP to IFRS. Finance management has already completed extensive training on IFRS, including the IFRS Immersion Course held by the CICA, and more training is planned. We have established a steering committee that is led by finance management and includes representatives of senior

management, taxation, operations, information technology and corporate communications.

Our implementation of IFRS consists of three primary phases as follows:

[a] Scoping and diagnostics

This phase involves performing a high-level impact assessment to identify key areas that may be impacted by the transition to IFRS. Based on our preliminary assessment we have ranked potentially affected areas as high, medium or low priority.

[b] Impact analysis, evaluation and design

This phase involves the identification of all the major components of the IFRS conversion plan and the preparation of a timeline for completion of each of those components. It includes the specification of changes to existing accounting policies, information systems and business processes that are required. In addition, we will analyze policy alternatives allowed under IFRS. This analysis will include an evaluation of the transitional provisions of *IFRS 1 – First-time Adoption of IFRS* (see pages 40–41) and the development of draft IFRS financial statement content.

[c] Implementation and review

This phase includes execution of changes to information systems and business processes, and selecting and obtaining formal approval of recommended accounting policy changes. Further training for our finance and other staff will be completed as necessary. We will closely monitor exposure drafts issued by the International Accounting Standards Board ("IASB"), the International Financial Reporting Interpretation Committee and other standards setters on an ongoing basis to ensure adoption of any relevant updates to standards that may take place during the period of transition to IFRS. This phase will culminate in the collection of the financial information necessary to compile IFRS-compliant financial statements, the absorption of IFRS within all relevant business processes and Audit Committee approval of IFRS financial statements.

Although we have not yet determined the full effects of adopting IFRS, key areas where significant changes in accounting policies are required or are being considered are as follows:

International Accounting Standards ("IAS") 16 – Property, Plant and Equipment:

Consistent with Canadian GAAP, separable components of property, plant and equipment are recognized initially at cost. Under *IAS 16*, an entity may subsequently carry all items of property, plant and equipment of a class at fair value rather than historical cost. The amortization charge is to be determined separately for each significant part of an item of

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

property, plant and equipment. We have not yet determined if we will carry any of our existing or future acquisitions of property, plant and equipment at fair value. The transition from Canadian GAAP to IFRS will require a comparison of our current stratification of property, plant and equipment for amortization purposes to that required in *IAS 16*, and will likely result in more amortization categories and an overall acceleration of amortization under this standard than is currently the case under Canadian GAAP.

IAS 36 – Impairment of Assets:

The requirements of Canadian GAAP and IFRS for testing long-lived assets for impairment are similar; however, major differences exist with regard to the frequency or timing of tests for impairment, the level at which the impairment test is performed, and the approach taken for the impairment test. These differences could result in more impairments being recognized under IFRS than would be recognized under Canadian GAAP. The requirements of Canadian GAAP and IFRS for testing goodwill for impairments are also similar but differences do exist in terms of the level at which the test is performed and the approach taken. However, it is not expected that we would incur any impairment of existing goodwill as a result of adopting the impairment testing methodology required under IFRS.

IFRS 2 – Share-based Payments:

Under Canadian GAAP, our liability with respect to our outstanding cash-settled share-based compensation plan is measured based on vesting and the intrinsic value of any increase in the share value from the issue date. Under *IFRS 2*, the liability is measured at the fair value of the units by applying an option pricing model, taking into account the terms and conditions on which the units were granted and the extent to which the employees have rendered service to date. The adoption of *IFRS 2* will result in the acceleration of cash-settled share-based compensation expense during the earlier periods of the vesting term relative to Canadian GAAP, but by the end of the vesting term, both *IFRS 2* and Canadian GAAP will result in the same amount of cumulative cash-settled share-based compensation expense being recorded.

IAS 21 – The Effects of Changes in Foreign Exchange Rates:

Canadian GAAP does not explicitly require a reporting entity to assess the basis for determining the currency in which it reports its financial results and position. Under IFRS, the reporting entity must determine its functional currency in conjunction with the currency of the primary economic environment in which the entity operates. Based on existing events, conditions and underlying transactions, we may be required to declare the U.S. dollar as our functional currency. However, we will still have the option under IFRS to report our financial results and position in Canadian dollars.

IAS 12 – Income Taxes:

The adoption of *IAS 12* will change the measurement of some income tax amounts and require more extensive disclosure than under Canadian GAAP. The IASB is in the process of reviewing this area and a significantly revised standard is expected to be released prior to 2011 so the analysis of current differences between Canadian GAAP and *IAS 12* is of limited relevance.

IAS 1 – Presentation of Financial Statements:

IAS 1 requires a separate statement of retained earnings. It presents the option of presenting assets and liabilities in order of liquidity if current and non-current classification is not meaningful. It allows for expense classification by nature or function, whichever is reliable and more relevant. The direct method is preferred for the disclosure of cash flow from operating activities. *IAS 1* requires significantly more financial statement disclosures regarding the basis for measurements and judgments than does current Canadian GAAP. Some differences exist in financial reporting terminology between IFRS and Canadian GAAP. As a result of all of these differences, the presentation of our financial statements under IFRS will undergo some significant changes from the presentation of financial statements under current Canadian GAAP.

IFRS 1 – First-time Adoption of IFRS:

This standard provides the framework for the first time adoption of IFRS. Certain one-time, optional and mandatory exemptions from full retrospective application of IFRS standards exist and are outlined within this standard. The *IFRS 1* exemptions that are the most relevant to us are as follows.

ESTIMATES

At the date of transition to IFRS, all estimates previously made under Canadian GAAP must be reviewed and adjusted where necessary to conform to any accounting policy changes made due to the conversion to IFRS, but are not to be otherwise adjusted unless there is objective evidence that those estimates were in error. Any changes to estimates that are made in this regard should reflect conditions as at the date of transition and be made on a mandatory prospective basis. We will undertake a thorough review of this area but we do not anticipate any significant changes in estimates as a result of this *IFRS 1* exemption.

BUSINESS COMBINATIONS

Under *IFRS 1*, there is the option available but not a requirement to restate any past business combination in order to be fully compliant with *IFRS 3 – Business Combinations*. We intend to review past business combinations in the context of *IFRS 3* in determining if and how retrospective adoption will materially affect the recording of past business combinations. If retrospective adoption is warranted, we will need to determine if adequate information is available within the accounting records to conform with *IFRS 3* retrospectively.

FAIR VALUE OR DEEMED COST

IAS 16 stipulates the elements of costs that are included as part of the cost of property, plant and equipment. It also prescribes significant stratification of each component of property, plant and equipment for amortization purposes. One option under *IFRS 1* is to recalculate original cost and amortization terms previously determined under Canadian GAAP retrospectively in accordance with *IAS 16*. Alternatively, we can adopt a fair-value method for any elements of property, plant and equipment at our discretion and designate fair value as deemed cost under *IFRS 1*. It is expected that our review of this area will be a significant undertaking and could result in adjustments to the net book value of certain property, plant and equipment assets previously determined under Canadian GAAP.

CUMULATIVE TRANSLATION ADJUSTMENT

IAS 21 requires the disclosure of cumulative translation differences as a separate component of equity similar to Canadian GAAP. If we choose to adopt *IAS 21* retrospectively it could result in cumulative translation differences that are different from those previously calculated under Canadian GAAP. Alternatively, *IFRS 1* allows previously determined cumulative translation differences to be reset to zero at the date of transition. We have not yet decided which alternative we will adopt.

SHARE-BASED PAYMENT TRANSACTIONS

For equity-settled share-based payment transactions, *IFRS 1* provides for exemption of retrospective application of *IFRS 2 (Share-based Payments)* for previously issued equity instruments that are fully vested prior to the date of transition. *IFRS 1* only allows retrospective application of *IFRS 2* if the fair value of these vested equity instruments at the *IFRS 2* measurement date (generally the grant date) has been previously disclosed. We will evaluate if the application of *IFRS 2* retrospectively to this category of previously issued stock options will result in any material adjustments and then we will decide whether or not to implement this alternative. For cash-settled share-based payment transactions, *IFRS 1* allows for the exemption of retrospective

application of *IFRS 2* for liabilities arising from share-based payment transactions that were settled before the date of transition to *IFRS*.

IFRS 2 requires the fair value of cash-settled share-based payment liabilities to be assessed each period by applying an option pricing model. We have ongoing stock-based compensation plans of this type and only grants issued in 2008 and earlier will be settled by the *IFRS* transition date. We will assess the effect of retrospective application of *IFRS 2* to grants issued in 2008 and earlier, and determine if we want to select the option of exemption from retrospective application of *IFRS 2* for this grant category. No exemption from retrospective application is available for grants issued in 2009 or later since they will not be settled by the *IFRS* transition date; therefore, we will be required to be in full compliance with *IFRS 2* with respect to those grants on a retrospective basis upon the *IFRS* transition date.

Our assessment to date of the implications of implementing *IFRS* has not revealed any requirements to significantly alter current information technology and data systems.

We will need to review and enhance internal controls over financial reporting to ensure that those controls accommodate the increased rigour of financial reporting and disclosure within an *IFRS* environment.

Ongoing disclosure of the specifics of accounting policy changes and the preparations for the changeover to *IFRS* will be made in accordance with the Canadian Securities Administration (“CSA”) Staff Notice: 52-320 – *Disclosure of Expected Changes in Accounting Policies Related to Changeover to International Financial Reporting Standards*. External communication of the progress made on the *IFRS* implementation plan and the expected changes to our financial reporting and disclosure will be evaluated and screened by both our *IFRS* Steering Committee and our Disclosure Committee.

The changeover to *IFRS* is not expected to have a significant effect on our ongoing business activities. Foreign exchange hedging, compliance with debt covenants, capital requirements and compensation arrangements are not expected to be materially affected by the transition to *IFRS*.

Financial Instruments

Certain current assets and liabilities, which are subject to normal trade terms, are financial instruments for which the recorded carrying values approximate the fair value. We are, however, exposed to financial market risks, including foreign currency exchange rates and interest rates on operating line of credit obligations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *continued*

Foreign currency risk

We operate internationally, and the majority of our revenue and a significant amount of our expenditures are denominated in U.S. dollars. During the year, we entered into forward foreign exchange contracts to manage foreign exchange exposure on anticipated U.S.-dollar sales transactions and the collection of the related accounts receivable. At July 31, 2009, the following were outstanding:

in thousands; Canadian dollars unless noted

Settlement date	Forward rate	Face value	Fair value at July 31, 2009
August 31, 2009	1.1502	US\$ 5,000	\$ 330
September 30, 2009	1.1500	5,000	329
October 29, 2009	1.2291	5,000	724
November 30, 2009	1.1494	5,000	326
December 31, 2009	1.1490	5,000	324
		US\$ 25,000	\$ 2,033

Interest rate risk

We are exposed to interest rate risk on borrowings under our revolving operating line of credit, which is subject to a variable interest rate. During the year, we entered into U.S.–Canadian dollar currency swaps for the purpose of lowering the interest expense associated with the Canadian-dollar utilization of our operating line of credit. At July 31, 2009, one was outstanding; the principal amount of the swap was US\$7.0 million; it expired on September 18, 2009. The swap is marked to market at July 31, 2009. We held it to maturity and paid fixed-fee swap costs of \$0.2 million for the swap.

Risks and Uncertainties

We are subject to certain risks and uncertainties inherent in the operation of our business. We attempt to mitigate these risks through a combination of sound risk-management practices, insurance and systems of internal control. The principal risks and uncertainties include but are not limited to the following.

Risks associated with new product development

One of our core competencies is research and development of new biopharmaceutical products. Many of our products are still under development. Considerable costs are incurred at every stage of identifying, developing, manufacturing and marketing new products.

There can be no assurance during any given research or development stage that any viable new products will be developed for which a market demand exists. The costs of conducting basic and clinical research to identify potential new product opportunities can be significant. There can be no assurance during any development stage that any new products developed will receive regulatory approval. If approved, some of these products will compete with established products of proven safety and efficacy, the manufacturers of which can be expected to employ intellectual property challenges against our commercialization of these products. There can be no assurance that our products will be commercialized or, if commercialized, that medical centres, hospitals, physicians or patients will accept them in lieu of established treatments. Accordingly, there can be no assurance that these products can be manufactured successfully and/or marketed profitably.

Dependence on availability and quality of raw materials

Our profitable manufacture of hyperimmune products is dependent upon a supply of specialty plasma. We collect plasma from donors through both our own and third-party collection centres, and accordingly are subject to donor participation. Furthermore, the level of antibodies in the plasma of donors is variable and, unless concentrations are sufficient, the cost of processing plasma to the end product may not be economically viable. We believe that we currently have sufficient relationships with third-party plasma collection centres to provide an adequate supply of plasma for the foreseeable future. However, competition for plasma, in terms of quality, volume and price, is increasing and there can be no assurances that shortages will not develop. We are taking steps to increase our own collection capacity, but there is no guarantee of the level of donor participation.

Compliance with regulatory requirements

Our ability to manufacture and ship our products is subject to numerous regulatory requirements and conditions that are complex and evolving. The supply of product, and hence revenue generation, could be interrupted should compliance become an issue. There can be no assurance that we will remain in compliance at all times, although we undertake continuous and stringent quality assurance, quality control and regulatory review processes internally to minimize this risk.

Reliance on distribution relationships

A significant portion of our revenues from product sales is derived from sales through exclusive distributors in Canada, the U.S. and international markets. For example, a sole distributor has the rights to distribute WinRho[®] SDF outside Canada. And in Canada, a sole distributor has rights to WinRho[®] SDF, HepaGam B[®] and VariZIG[™]. As a result, we are relying on the sales and marketing strength, and distribution channels through which these distributors operate for a significant portion of our revenues. There can be no assurance that we will be able to retain these distribution relationships indefinitely and that we will be able to rely upon the sales, marketing and distribution efforts of these distributors to support sales of these products in these significant markets.

Potential liabilities associated with intellectual property claims

Certain of our biopharmaceutical products may compete with existing products in the marketplace, and due to the nature of the products being developed and the complexity of the law governing intellectual property rights, we may face increasing exposure to intellectual property claims. Defending intellectual property claims, whether or not such claims have merit, may result in us incurring significant legal costs. An inability to defend such claims could lead to loss of rights to manufacture and sell a product, even after significant costs have been incurred for development and licensing. There can be no assurances that we will not become subject to intellectual property claims, nor can there be any assurance that we would be able to successfully defend such claims.

Customer concentration and reliance on contracts

We are party to contracts with Canadian and U.S. government agencies, a small number of other third parties, and Apotex, a related party. A significant portion of our revenue comes from a small number of contract customers; there can be no assurance that these customers will continue to purchase products or services from us at current levels or at all.

Fluctuations in demand

We have entered into contracts and submitted proposals to develop and manufacture products for use in biodefence programs. By their nature, these contracts call for us to supply such products to a national stockpile to be used in the event of an actual incident or attack. Accordingly, demand for these products should be expected to fluctuate significantly, both at the time of establishing initial stockpiles and in the event of their use or replacement in the stockpile. There is no way to precisely predict the level of future demand for such products. In the event of a crisis, we may be called upon by governments to dedicate capacity to the manufacture of certain biodefence products, which would impact our ability to meet customer demand for other products.

Foreign markets

WinRho[®] SDF is licensed and sold in many countries worldwide. Certain other products are also sold internationally. We view international markets as having significant potential for market expansion. Although we believe that the international political and regulatory environment has not presented a sustained barrier to our ability to ship product in the past, each country has its own regulatory requirements, and introduction of products into new markets can take substantial time. There can also be no assurance that future political or regulatory events will not impede distribution of products to international markets in the future. In addition, we may incur significant upfront costs in efforts to gain entry to these markets. There can be no assurance that these markets will yield sufficient revenues to recover the costs of entry, or to sustain marketing efforts in these jurisdictions.

Competition

We compete in a number of segments within the biopharmaceutical industry, some of which are highly competitive. Traditional pharmaceutical companies are increasingly entering biologics markets. And competition in the contract-services segment in North America appears to be intensifying, with a small number of well-positioned organizations attempting to provide a complete suite of services. We anticipate we will compete with a number of larger manufacturers for the production of certain biopharmaceutical products. In addition, we anticipate facing increasing competition as we attempt to further penetrate existing markets and expand our products into new markets. Given these industry characteristics, existing or new competitors may be significantly larger and have greater financial, research, manufacturing or marketing resources than ours. These competitors may compete with us in providing both products and services in markets in which we currently operate, as well as competing to enter new markets where we desire to expand. Further, competitors may employ tactics such as intellectual property challenges or government lobbying to prevent or impede our success at expanding our markets or maintaining regulatory status. There can be no assurances that we will be able to achieve or maintain our desired market share in any particular industry segment or market.

Foreign currency risk

As noted previously, the majority of our revenues are generated from non-Canadian customers and accordingly are typically transacted in foreign currencies, primarily in U.S. dollars. Although we also incur significant U.S.-dollar-denominated expenses, there has historically been a net inflow of U.S. dollars. In addition, our net income can be materially affected directly by exchange rate fluctuations as net income from U.S. operations is translated into Canadian dollars for reporting purposes.

The preceding cautionary statements should be considered in connection with all written or oral statements, especially forward-looking statements, that are made by Cangene or by persons acting on its behalf and in conjunction with its periodic disclosure and related filings with the securities commissions. It undertakes no obligation to publicly make or update any forward-looking statements, except as required by applicable law.

Scientific information that relates to unapproved products or unapproved uses of products is preliminary and investigative. No conclusions can or should be drawn regarding the safety or efficacy of such products. Only regulatory authorities can determine whether products are safe and effective for the uses being investigated. The discussion in this document is intended as an investor summary and does not contain all relevant safety information. Healthcare professionals are directed to refer to approved labelling and appropriate prescribing information for products and not to rely on information discussed in investor documents. Prescribing information or drug names may differ in various countries.

Additional Information

Additional information relating to Cangene Corporation, including the most recently filed Annual Information Form, can be found on our website at www.cangene.com or on SEDAR at www.sedar.com.