

## Letter to the Shareholders

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The Company achieved several important milestones during the third quarter, including the commencement of a Phase I human clinical trial evaluating AL-208 as a treatment for mild cognitive impairment (MCI) associated with cardiac artery bypass graft (CABG or bypass) surgery. In addition, we remain on track to report data from this Phase I trial and to commence a Phase IIa trial for this indication early in 2006.

In addition to these clinical developments, other achievements during the quarter included:

- The listing of common shares on the Toronto Stock Exchange and commencement of trading on September 21, 2005;
- A private placement of common shares to a group of largely institutional investors for gross proceeds of \$6.3 million providing the Company with approximately two years cash;
- Several corporate and scientific conference presentations including the Orion Securities' 10th Annual Healthcare Conference; and
- Publication in the Journal of Neuroscience of a preclinical study extending the Company's body of research that demonstrates Allon's compounds have the potential to protect and repair brain cells from disease or injury.

### Unique Portfolio of Drug Compounds

Allon is developing drugs that protect against neurodegenerative conditions. Allon's compounds treat the causes of neurodegenerative conditions, while therapies currently available to patients address only the symptoms of the conditions. These symptomatic treatments for neurodegeneration represent the second leading pharmaceutical market in the world, at approximately \$24.4 billion in 2004.

A common characteristic found in patients with neurodegenerative conditions is the death of neurons that occurs as a result of a breakdown of microtubules (cylindrical strands of protein). When microtubules break down, the axonal transport within a cell and the chemical transmission between them are disrupted. This disruption causes neurons to die. Allon's compounds prevent neuronal cell death by binding to neuron-specific tubulin, subsequently repairing the microtubular network as well as potentially restoring both axonal transport within nerve cells and chemical transmission between them.

Allon's compounds are also unique because they have shown efficacy in eight different pre-clinical models of central nervous system diseases. We are taking advantage of this broad effectiveness with a clinical strategy to develop our compounds in two different routes of administration — intranasal and intravenous — and in disease indications where the outcomes are measured by cognitive performance and functional performance. This strategy builds value into this proprietary class of neuroprotective compounds and enhances our opportunity to succeed in their development as well as capitalize on large market opportunities.

Currently we have two compounds, AL-108 and AL-208, in clinical trials.

### AL-108

During Q2, the Company successfully completed a Phase Ia human clinical trial evaluating AL-108 as a treatment for Alzheimer's disease. AL-108 was given intranasally to five groups of six healthy adults in a double-blind, placebo-controlled, randomized and ascending dose study to evaluate the safety

and pharmacokinetic results. The dosing was well tolerated by all subjects and no meaningful side effects were observed.

In Q3, after discussion with the United States Food and Drug Administration (FDA), we opted to conduct additional pre-clinical work with AL-108 before commencing a Phase Ib trial next year. The advantage of this work is that it will allow us to better understand the pharmacokinetics and pharmacodynamics (how a drug interacts with and moves through the body) of AL-108. This information will provide for a superior design for the Phase IIa trial we expect to commence next year. We expect to complete this additional preclinical work and to commence the Phase Ib trial in the first half of 2006. Thereafter, we expect to complete the Phase Ib trial and commence a Phase IIa trial as a first stage to determining effectiveness in patients in the second half of 2006.

There are 16 million Alzheimer's patients in the seven major pharmaceutical markets who currently have no effective treatment, notwithstanding more than US \$2-billion spent annually on the therapies that are now on the market. This disease will only increase in the forthcoming years.

### **AL-208**

During Q3, Allon began dosing patients in a Phase I human clinical trial evaluating AL-208 as a treatment for MCI associated with bypass surgery. AL-208 was administered intravenously to six dose groups totalling 48 healthy adults and two additional dose groups totalling 16 healthy elderly adults in a single-dose, double-blind, placebo controlled, randomized, sequential and ascending study to evaluate primarily the safety and pharmacokinetic results.

Subsequent to quarter end, we announced that we have completed dosing subjects in this trial, expect to release data in Q1 2006, and begin a Phase IIa trial early in 2006 as a first stage to determining effectiveness in patients.

Approximately 500,000 patients in the United States and 800,000 patients worldwide undergo bypass surgery every year. The post-bypass MCI market is estimated to be \$3 billion annually. Currently, there is no therapy available that ameliorates or treats the cognitive damage associated with bypass surgery.

### **Third Indication**

In addition to Alzheimer's disease and MCI, we advanced our internal deliberations in Q3 to select a third indication to pursue in clinical development and further demonstrate the broad capacity of these compounds. We expect to announce our selection of a third indication early in 2006.

### **Toronto Stock Exchange Listing**

On September 20, 2005, Allon received approval to list its common shares on the Toronto Stock Exchange (TSX) and began trading on September 21, 2005 under the symbol "NPC" (Neuro Protection Company). The TSX listing provides additional exposure for Allon to investors and reflects the progress Allon has made developing therapeutic solutions for patients with neurodegenerative conditions. Allon's CEO and CFO, together with senior executives of the exchange, marked the Company's debut on the TSX with a bell-ringing ceremony to open trading.

### **\$6.3 Million Financing**

On August 29, 2005, Allon completed a private placement of common shares to a group of largely institutional investors at a price of \$1.05 per share for gross proceeds of \$6.3 million. The placement proceeds will be used to fund ongoing clinical development of AL-108 and AL-208. We are now in the position of having the financial resources to undertake Phase IIa clinical trials for both products.

## Presentations and Publications

During the quarter, members of our management team presented at six scientific and corporate conferences. These conferences provided Allon the opportunity to present updates on our performance milestones and our research and clinical development programs. Presentations were made by invitation at Orion's 10th Annual Healthcare Conference in Mt. Tremblant, Quebec; the Neuropeptide 2005 Conference in Miami, Florida; the Nasal Drug Delivery Conference in Washington, DC; the VIP/Peptides conference in Rouen, France; Neurogenesis, a therapeutic strategy conference, in New York; and ECTRIMS/ACTRIMS (European Committee for Treatment and Research in Multiple Sclerosis / Americas Committee for Treatment and Research in Multiple Sclerosis) in Thessaloniki, Greece.

## Board Appointment

Allon announced the appointment of Gordon C. McCauley, the Company's president and chief executive officer, to its Board of Directors.

## Subsequent Events

In October, we announced expanding the protocol of our AL-208 Phase I study for MCI associated with bypass surgery by adding two additional dose groups of healthy elderly adults. Doing so will enable us to proceed more quickly into a Phase IIa clinical trial for this indication.

Coinciding with the Phase IIa trial in early 2006, we also decided to conduct a multiple-dose Phase Ib study for AL-208. This multiple ascending dose study will evaluate the safety and pharmacokinetics of AL-208 in healthy elderly adults and in patients with Type I and Type II diabetes. Proceeding with a Phase Ib clinical trial will broaden the safety profile and ensure that Allon will be able to use the AL-208 intravenous product in indications where multiple doses are required.

In October, we launched a new website to better communicate our plans and prospects to shareholders and other audiences. The redesigned and enhanced site contains more content and has a simplified navigation structure. We invite you to visit our new website at [www.allontherapeutics.com](http://www.allontherapeutics.com).

On November 1, Allon relocated its office to a larger location at #506-1168 Hamilton Street, Vancouver, B.C. V6B 2S2 Canada. Our phone number 604-736-0634 remains the same, as does our fax 604-736-1616. All direct dial numbers and email addresses remain the same.

We believe we have a significant opportunity at Allon with our unique class of compounds and the team we have built to conduct clinical development. We remain focused on building shareholder value through consistently executing on our development and commercialization strategy. We thank all of our shareholders for your continued support, and we look forward to updating you on our progress as we continue to move forward.

Respectfully,



James J. Miller, PhD  
Chairman



Gordon C. McCauley  
President & CEO

November 10, 2005



# Management's Discussion & Analysis

## For the three and six month periods ended September 30, 2005

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*The following information should be read in conjunction with the unaudited consolidated financial statements and related notes for the Company for the third quarter (Q3 2005) and year to date (YTD 2005) operations ended September 30, 2005, as well as the audited annual financial statements, their accompanying notes and management's discussion and analysis for the year ended December 31, 2004 included in our Annual Report (2004 Annual Report). The financial statements listed have been prepared in accordance with Canadian generally accepted accounting principles. All dollar amounts are expressed in Canadian dollars unless otherwise specified. Additional information relating to Allon Therapeutics Inc. ("Allon" or the "Company") can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com).*

November 10, 2005

### OVERVIEW

Allon Therapeutics Inc. is a development-stage Canadian biotechnology company developing drugs that protect against a variety of neurodegenerative conditions such as Alzheimer's, stroke, traumatic brain injury, multiple sclerosis and neuropathy. The Company is listed on the Toronto Stock Exchange (TSX) under the trading symbol "NPC" (Neuro Protection Company<sup>TM</sup>) and based in Vancouver.

During the third quarter of 2005 (Q3 2005), the Company achieved several important drug development milestones. In July the FDA made active the Company's Investigational New Drug (IND) application to begin Phase I human clinical trials of its second drug product AL-208. AL-208 is intended as a treatment for mild cognitive impairment (MCI) associated with cardiac artery bypass graft (CABG) surgery. The application was made active without comment during the statutory 30-day review period enabling the Company to proceed immediately with the Phase I clinical trial. During the quarter, the Company began dosing, intravenously, to eight dose groups including healthy adults and healthy elderly adults. Dosing was completed shortly after the end of Q3 2005. The Phase I trial is scheduled for completion in the fourth quarter of 2005 (Q4 2005), with the expectation that data will be released in the first quarter of 2006 (Q1 2006).

Following results of its Phase Ia trial for AL-108, which demonstrated that a single dose was safe and well tolerated when administered to healthy adults, the Company continued to conduct further pre-clinical work to obtain data for the next stage of drug development. The next stage of development, planned for the second quarter of 2006 (Q2 2006), is a Phase Ib trial designed to determine the safety and tolerability of the drug in patients most at risk for Alzheimer's disease.

During Q3 2005, the Company achieved two corporate milestones. In August, the Company completed a \$6.3 million dollar private placement of common shares. Proceeds of the share issue will fund research of current drug products into the fourth quarter of 2007 (Q4 2007). In September, the Company graduated from a Venture issuer to a listed member of the TSX.

The Company has \$11.2 million in cash and short term investments. Working capital is \$11.1 million. The Company's believes its current financial position and interest earned on investments will enable it to fund operations into Q4 2007.

## **RESULTS OF OPERATIONS**

For the three months ended September 30, 2005 the Company reported a net loss of \$1,492,248 (\$0.05 per share) compared to a loss of \$356,098 (\$0.04 per share) for the same period in 2004 (Q3 2004) and a loss of \$1,261,196 (\$0.05 per share) for the previous quarter ended June 30, 2005 (Q2 2005). The increased loss of \$1,136,150 over the comparable three months ended Q3 2004 resulted from the acquisition of Allon Therapeutics, Inc. (Allon USA) and subsequent change of business the Company underwent in Q3 2004 from an investment company to a biotechnology company. Q3 2005 losses are reflective of the Company's clinical development program. The increased loss of \$231,052 over Q2 2005 is the result of planned increases in both R&D and G&A. R&D increases are largely the result of the commencement of clinical development for the Company's second compound, AL-208. Additional G&A costs were associated with the Company's transition from a Venture issuer to a TSX listed company and successful completion of a \$6.3 million private placement.

For the nine month period ended September 30, 2005, the Company reported a loss of \$3,957,259 compared to \$579,565 for the same period in 2004. The increased loss of \$3,377,694 results from the acquisition of Allon USA and subsequent change of business.

## **REVENUE**

For the three months ended September 30, 2005, the Company had revenue of \$73,045 compared to \$112,375 in Q3 2004 and \$25,629 in Q2 2005. In Q3 2005 the Company earned \$58,045 from investments and \$15,000 from grant revenue, compared to \$20,233 from investments and \$92,042 from management fees in Q3 2004 and \$25,629 from investments in Q2 2005. The \$39,330 decrease from Q3 2004 is the result of the loss of management fee revenues with the change in business, partially offset by grant income and a \$38K increase in interest revenue from larger cash reserves and higher interest rates earned on investments.

For the nine month period ended September 30, 2005, the Company had revenue of \$163,044 compared to revenue of \$378,415 for the same period in 2004. The \$215,371 decrease results from the loss of management fee revenues with the change in business, partially offset by the receipt of grant revenues and a \$116K increase in interest revenue from larger cash reserves and higher interest rates earned on investments. Having divested itself of its investment management assets at the end of Q3 2004, the Company does not expect to earn management fees going forward.

## **EXPENSES**

### **RESEARCH AND DEVELOPMENT**

For the three month period ended September 30, 2005, research and development expenses were \$988,691 compared to \$nil in Q3 2004 and \$830,576 in Q2 2005. The increase over Q3 2004 is due to the change in business. Q3 2005 expenses were \$158,115 greater than Q2 2005 primarily due to the timing of clinical trial costs associated with the progression of the clinical development plan. While the Q2 2005 focus was on submission of the AL-208 IND filing, planning and preparatory work for AL-108 and AL-208 clinical trials, in Q3 2005 the Company commenced its Phase I clinical trial for AL-208. The goal of the trial is to evaluate the safety and pharmacokinetic results of the drug in healthy adults and healthy elderly adults. Subsequent to quarter end, the Company completed the dosing component of the trial and expects to release data in Q1 2006. During Q3 2005, the Company also initiated additional preclinical studies for AL-108 and expects to commence a Phase Ib clinical trial in the first half of 2006.

For the nine month period ended September 30, 2005, research and development expenses were \$3,131,030 compared to \$nil for the same period last year. This year the Company commenced and completed the AL-108 Phase Ia clinical trial. Additionally, the Company has initiated and, subsequent to the end of the quarter, completed dosing for its Phase I clinical trial for AL-208. The Company has made significant progress in its pre-clinical and clinical research to build on the body of knowledge supporting the Company's unique class of compounds.

#### GENERAL AND ADMINISTRATIVE

For the three month period ended September 30, 2005, general and administrative expenses were \$402,323 compared to \$260,024 in Q3 2004 and \$360,867 in Q2 2005. The \$142,229 increase over Q3 2004 primarily relates to costs incurred to transition Allon from a Venture issuer to a TSX listed company, complete the \$6.3 million dollar private placement and for increased salaries reflecting additional personnel required to support the change in business. The \$41,456 Q3 2005 increase over Q2 2005 primarily relates to costs incurred to transition Allon from a Venture issuer to TSX listed company and to support the \$6.3 million dollar private placement.

For the nine month period ended September 30, 2005 general and administrative expenses were \$1,090,148 compared to \$817,216 for the same period last year. The increase of \$272,932 results from costs incurred for Allon's graduation from a Venture issuer to a TSX listed company and increased staff and related expenses associated with the Company's transition to a biotech development company. YTD 2005 increases were partially offset by lower legal fees than those incurred in 2004 to complete the purchase of Allon USA and the subsequent change in business.

#### AMORTIZATION

Amortization expenses for the three months ended September 30, 2005 increased to \$137,344 in Q3 2005 compared to \$3,458 in Q3 2004 and \$135,851 in Q2 2005. Amortization for the nine months ended September 30, 2005 was \$408,604, compared to \$9,823 for the same period last year. The quarter over quarter and YTD increases from prior year primarily result from the acquisition of licenses and other intangible assets of Allon USA at the end of Q3 2004.

#### OTHER INCOME/(EXPENSES)

For the three months ended September 30, 2005, the Company incurred other expenses of \$177,576 compared to \$204,991 in Q3 2004 and of \$116,817 in Q2 2005. In Q3 2005 other expenses decreased by \$27,415 compared to the same period in 2004. In Q3 2005 other expenses included increased stock based compensation expense and foreign exchange exposure relating to investment of cash reserves and translation of financial statements whereas other expenses in Q3 2004 were primarily due to losses on investments. For the nine month period ended September 30, 2005, the Company incurred other expenses of \$262,532 compared to \$130,941 for the same period in 2004. The \$131,591 increased expense results from \$131K in foreign exchange, \$112K increase in stock based compensation expense, and \$6K in interest expense, compared to a prior year \$116K net loss on investments and \$5K write down on marketable securities.

## QUARTERLY INFORMATION

The following is selected quarterly financial information for Allon, for the eight most recently completed quarters:

(in thousands, except per share data)

|   | <b>Sept 30, 2005</b>  | <b>June 30, 2005</b> | <b>March 31, 2005</b> | <b>Dec. 31, 2004</b> |
|---|-----------------------|----------------------|-----------------------|----------------------|
| Investment earnings and management fees                 | \$73                  | \$26                 | \$64                  | \$11                 |
| Loss before unrealized gains (losses) on investments    | \$(1,492)             | \$(1,261)            | \$(1,204)             | \$(1,110)            |
| Write-down and unrealized gains (losses) on investments | nil                   | nil                  | nil                   | \$37                 |
| Loss for the quarter                                    | \$(1,492)             | \$(1,261)            | \$(1,204)             | \$(1,073)            |
| Loss per share  | \$(0.05)              | \$(0.05)             | \$(0.04)              | \$(0.05)             |
|   | <b>Sept. 30, 2004</b> | <b>June 30, 2004</b> | <b>March 31, 2004</b> | <b>Dec. 31, 2003</b> |
| Investment earnings and management fees                 | \$112                 | \$117                | \$150                 | \$168                |
| Loss before unrealized gains (losses) on investments    | \$75                  | \$(156)              | \$(62)                | \$(253)              |
| Write-down and unrealized gains (losses) on investments | \$(431)               | \$(13)               | \$8                   | \$(20)               |
| Loss for the quarter                                    | \$(356)               | \$(169)              | \$(54)                | \$(273)              |
| Loss per share  | \$(0.04)              | \$(0.02)             | \$(0.01)              | \$(0.02)             |

As the investment management business developed, investment earnings and management fees increased as shown in the three months ended December 31, 2003 and remained relatively stable over the next two quarters. The difference in the loss and loss per share for the three months ended December 31, 2003, March 31, 2004 and June 30, 2004 were largely a result of varying gains on the sale of marketable securities in each quarter.

In the three months ended September 30, 2004, the Company divested the investment management assets consisting of two wholly-owned subsidiaries and the investment management contract of a fund. The gains from the sale of the two subsidiaries and the contract were more than offset by the write-down of the remainder of the Company's corporate investments. These transactions were part of a change of business which saw the Company acquire Allon USA, a San Diego based biotechnology company, and change its name to Allon Therapeutics Inc. in order to focus the Company on the development of Allon's technology.

The three months ended December 31, 2004 was the first quarter in which the operations of the Company were focused on the development of its neuroprotective compounds. The majority of the Company's expenses were in research and development and no management fees were earned.

In the three months ended March 31, 2005, the Company was focused on Phase I clinical trials for AL-108, pre-clinical work for the AL-208 IND and further scientific research for the Company's unique class of compounds. The majority of the company's expenses were in research and development.

In the three months ended June 30, 2005, the Company completed pre-clinical animal studies to confirm that both AL-108 and AL-208 penetrate the blood brain barrier to reach their target therapeutic areas in the central nervous system. The Company filed an IND for its second product, AL-208, seeking approval to begin human clinical trials evaluating it as a treatment for MCI associated with CABG. The company also completed preparatory work for both the AL-108 Phase Ib and AL-208 Phase I trials, scheduled to begin in Q3 2005.

In the three months ended September 30, 2005, the Company received FDA approval to begin Phase I human clinical trials to evaluate its second drug, AL-208 for treatment of MCI. Clinical trials for AL-208 were initiated and are proceeding as scheduled and will enable the company to proceed into a Phase IIa study in 2006. During Q3 2005 the Company graduated from a venture issuer to the TSX exchange and completed a \$6.3 million dollar private placement.

## **LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2005, the Company had cash and short-term investments of \$11,175,476 compared to \$9,266,403 at December 31, 2004 and \$6,339,427 at June 30, 2005. Short-term investments are held in high-grade, liquid commercial paper with maturities ranging from 30 days to 11 months to match the Company's future cash requirements.

The Company had working capital of \$11.1 million at September 30, 2005. There were 2.0 million stock options exercisable at prices between \$.001 and \$1.72 per share and 1.5 million warrants outstanding and exercisable at a price of \$1.25. If all outstanding stock options and warrants were exercised, proceeds of \$1.2 million and \$1.9 million would be generated respectively.

The Company believes that its cash and short-term investments as at September 30, 2005 and expected interest income will be sufficient to fund operations and commitments into Q4 2007.

## **OUTSTANDING SHARE CAPITAL**

At September 30, 2005, the Company had 33,386,711 common shares outstanding. Each common share entitles the holder to one vote per share. At September 30, 2005, the Company had 2,546,797 options outstanding, of which 2,046,796 were exercisable into an equivalent number of the Company's common shares at exercise prices ranging from \$0.001 to \$1.72. The Company also had 1,510,000 warrants outstanding as of September 30, 2005, entitling holders to purchase common shares of the Company until March 31, 2006, at a price of \$1.25. See Note 4 of the Company's financial statements for more detail regarding outstanding share capital.

## **CRITICAL ACCOUNTING ESTIMATES AND POLICIES**

The Company's critical accounting policies and estimates are disclosed in the Management's Discussion and Analysis of Financial Condition and Operations section and the annual consolidated financial statements contained in the 2004 Annual Report. In the first quarter of 2005, the Company adopted the recommendation of the Canadian Institute of Chartered Accountants (CICA) Handbook Accounting Guideline ACG-15, consolidation of Variable Interest Entities. This adoption of a new accounting standard has not had any impact on operating results.

## **RISKS AND UNCERTAINTIES**

As previously described, cash on hand, together with expected interest income is expected to be sufficient to fund operations and commitments into Q4 2007. Funding needs may, however, vary depending on a number of factors including progress in research and development, the cost associated with completing clinical trials and the regulatory approval process and the costs of enforcing and prosecuting patent claims and other intellectual property rights.

In general, prospects for companies in the biopharmaceutical industry may be regarded as uncertain given the nature of the industry, therefore, investments in such companies should be regarded as highly speculative. In the future, the Company will need to raise additional funds to continue research and development and clinical trials necessary for market approval. The company cannot guarantee that financing will be available or that terms for additional financing will be favourable.

Risks and uncertainties related to the Company's financial performance and certain industry factors are discussed in detail in the Management's Discussion and Analysis section of the 2004 Annual Report.

This discussion and analysis and other sections of the financial statements contain forward looking statements, which are based on the Company's current expectations and assumptions and are subject to a number of risk factors and uncertainties that could cause actual results to differ materially from those anticipated. Given these risk factors and uncertainties, readers are cautioned not to place undue reliance on such forward-looking information. Additional information relating to the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)  
Consolidated Balance Sheets

|   | September 30,<br>2005<br>(unaudited) | December 31,<br>2004<br>(audited) |
|---|--------------------------------------|-----------------------------------|
| <b>Assets</b>                                 |                                      |                                   |
| Current assets:                               |                                      |                                   |
| Cash and cash equivalents                     | \$ 379,321                           | \$ 963,403                        |
| Short-term investments                        | 10,796,155                           | 8,303,000                         |
| Marketable securities                         | -                                    | 6,163                             |
| Accounts receivable                           | 89,658                               | 107,248                           |
| Prepaid expenses and deposits                 | 143,916                              | 52,688                            |
|   | <u>11,409,050</u>                    | <u>9,432,502</u>                  |
| Long term receivable                          | 39,467                               | 56,519                            |
| Property, plant and equipment                 | 61,228                               | 50,903                            |
| Intangible assets                             | 7,195,951                            | 7,591,759                         |
|   | <u>\$ 18,705,696</u>                 | <u>\$ 17,131,683</u>              |
| <b>Liabilities and Shareholders' Equity</b>   |                                      |                                   |
| Current liabilities:                          |                                      |                                   |
| Accounts payable and accrued liabilities      | \$ 287,722                           | \$ 407,971                        |
| Convertible promissory note payable           | 7,196                                | 1,736                             |
| Future income tax liability                   | 828,120                              | 1,600,131                         |
| Shareholders' equity:                         |                                      |                                   |
| Share capital (Note 4)                        | 27,063,196                           | 20,766,549                        |
| Equity portion of convertible promissory note | 330,065                              | 330,065                           |
| Additional paid-in capital                    | 868,755                              | 747,330                           |
| Deficit                                       | (10,679,358)                         | (6,722,099)                       |
|   | <u>17,582,658</u>                    | <u>15,121,845</u>                 |
|   | <u>\$ 18,705,696</u>                 | <u>\$ 17,131,683</u>              |

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



James J. Miller, PhD  
Chairman



Frank Holler

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)

Consolidated Statements of Operations and Deficit  
(Unaudited)

|                                     | Three months<br>ended<br>September 30,<br>2005 | Three months<br>ended<br>September 30,<br>2004 | Nine months<br>ended<br>September 30,<br>2005 | Nine months<br>ended<br>September 30,<br>2004 |
|-------------------------------------|--|--|---|---|
| Interest                            | \$ 58,045                                      | \$ 20,333                                      | \$ 148,044                                    | \$ 32,543                                     |
| Grant Income                        | 15,000   |  | 15,000  |   |
| Management fees                     | -  | 92,042   | -   | 345,872                                       |
|                                     | 73,045   | 112,375  | 163,044                                       | 378,415                                       |
| Expenses:                           |  |  |   |   |
| Research and development            | 988,691  | -  | 3,131,030                                     | -   |
| General and administrative          | 402,323  | 260,024  | 1,090,148                                     | 817,216                                       |
| Amortization                        | 137,344  | 3,458  | 408,604                                       | 9,823   |
|                                     | 1,528,358                                      | 263,482  | 4,629,782                                     | 827,039                                       |
| Other (income)/expense:             |  |  |   |   |
| Unrealized loss on investments      |  | 431,122  |   | 345,438                                       |
| (Gain) on sale of investment assets |  | (229,256)                                      |   | (229,256)                                     |
| Foreign exchange loss               | 123,992  | -  | 131,159                                       | -   |
| Stock-based compensation (Note 5)   | 51,574   | 3,125  | 121,425                                       | 9,374   |
| Interest                            | 2,010  | -  | 5,885   | -   |
| Write-down of marketable securities | -  | -  | 4,063   | 5,385   |
|                                     | 177,576  | 204,991  | 262,532                                       | 130,941                                       |
| Loss before income taxes            | (1,632,889)                                    | (356,098)                                      | (4,729,270)                                   | (579,565)                                     |
| Future income tax recovery (Note 7) | 140,641  | -  | 772,011                                       | -   |
| Loss for the period                 | (1,492,248)                                    | (356,098)                                      | (3,957,259)                                   | (579,565)                                     |
| Deficit, beginning of period        | (9,187,110)                                    | (5,293,411)                                    | (6,722,099)                                   | (5,069,944)                                   |
| Deficit, end of period              | \$(10,679,358)                                 | \$(5,649,509)                                  | \$(10,679,358)                                | \$(5,649,509)                                 |
| Loss per share:                     |  |  |   |   |
| Basic and diluted (Note 6)          | \$ (0.05)                                      | \$ (0.04)                                      | \$ (0.14)                                     | \$ (0.06)                                     |

See accompanying notes to consolidated financial statements.

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)  
Consolidated Statements of Cash Flows  
(Unaudited)

|  | Three months<br>ended<br>September 30,<br>2005 | Three months<br>ended<br>September 30,<br>2004 | Nine months<br>ended<br>September 30,<br>2005 | Nine months<br>ended<br>September 30,<br>2004 |
|--|--|--|---|---|
| Cash flows provided by (used in):              |  |  |   |   |
| Operations:                                    |  |  |   |   |
| Loss for the period                            | \$(1,492,248)                                  | \$ (356,096)                                   | \$(3,957,259)                                 | \$ (579,565)                                  |
| Items not involving cash:                      |  |  |   |   |
| Amortization                                   | 137,344  | 3,458  | 408,604                                       | 9,823   |
| Interest on convertible promissory note        | 1,551  | -  | 5,460   | -   |
| Stock-based compensation                       | 51,574   | 3,125  | 121,425                                       | 9,374   |
| Write-down marketable securities               | -  | -  | 4,063   | (85,684)                                      |
| Unrealized loss on investments                 | -  | 431,122  | -   | 436,507                                       |
| (Gain) on sale of subsidiaries                 | -  | (229,256)                                      | -   | (229,256)                                     |
| Future income tax recovery                     | (140,641)                                      | -  | (772,011)                                     | -   |
| Change in non-cash operating working capital   | (32,005)                                       | 194,010  | (193,887)                                     | 161,450                                       |
|  | (1,474,425)                                    | 46,363   | (4,383,605)                                   | (277,351)                                     |
| Investments:                                   |  |  |   |   |
| Short-term investments                         | (4,529,338)                                    | 1,000,000                                      | (2,493,155)                                   | 1,172,212                                     |
| Purchase of property, plant and equipment      | (2,898)  | (5,588)  | (23,121)                                      | (10,285)                                      |
| Long-term receivable                           | 21,272   | (56,519)                                       | 17,052  | (56,519)                                      |
| Proceeds of sale of subsidiaries               | -  | 229,256  | -   | 229,256                                       |
| Proceeds of sale of marketable securities      | 2,100  | -  | 2,100   | 140,255                                       |
| Costs of business combination                  | -  | 1,544,371                                      | -   | 1,544,371                                     |
| Corporate investments                          | -  | -  | -   | 52,508  |
|  | (4,508,864)                                    | 2,711,520                                      | (2,497,124)                                   | 3,071,798                                     |
| Financing:                                     |  |  |   |   |
| Proceeds from issuance of common shares        | 6,290,000                                      | 7,808,626                                      | 6,296,647                                     | 7,808,626                                     |
| Increase/(decrease) in cash for the period     | 306,711  | 10,566,509                                     | (584,082)                                     | 10,603,073                                    |
| Cash and cash equivalents, beginning of period | 72,610   | 344,359  | 963,403                                       | 307,795                                       |
| Cash and cash equivalents, end of period       | \$ 379,321                                     | \$10,910,868                                   | \$ 379,321                                    | \$ 10,910,868                                 |
| Supplementary information:                     |  |  |   |   |
| Cash received during the year for:             |  |  |   |   |
| Interest                                       | \$ 42,830                                      | \$ 27,590                                      | \$ 69,056                                     | \$ 32,382                                     |

See accompanying notes to consolidated financial statements.

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)  
Notes to Consolidated Financial Statements  
(Unaudited)

Nine months ended September 30, 2005 and 2004

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## 1. Basis of presentation:

Allon Therapeutics Inc. ("Allon" or the "Company"), formerly Neuro Discovery Inc., is a public company incorporated under the Canada Business Corporations Act. Allon is a biopharmaceutical company engaged in the development of drugs to treat neurodegenerative diseases and disorders. During the third quarter of 2004, the Company underwent a change of its core business activities as it sold two of its investment management subsidiaries as well as the contract to manage an investment fund and acquired all of the outstanding securities of Allon Therapeutics, Inc. ("Allon USA"). Effective September 28, 2004 the Company changed its name to Allon Therapeutics Inc.

The continuation of the Company's research and development activities and the commercialization of its products in development are dependent upon the Company's ability to successfully complete its research and development programs and finance its cash requirements primarily through equity financing. The Company's current level of cash and short-term investments exceeds the amount required to execute the Company's current planned expenditures for the next 12 months.

In the opinion of management, all adjustments (including reclassifications and normal recurring adjustments necessary to present fairly the financial position, results of operations and deficit, and cash flows at September 30, 2005 and for all periods presented) have been made. Interim results are not necessarily indicative of results for a full year.

## 2. Significant accounting policies:

These interim financial statements are prepared by applying the same accounting policies and methods of their application as the annual financial statements of the Company, except that, effective January 1, 2005, the Company adopted the Canadian Institute of Chartered Accountants issued Accounting Guideline 15, Consolidation of Variable Interest Entities ("AcG-15"). AcG-15 clarifies the identification of that entity which is required to consolidate other entities in situations where the majority voting interest may not identify the party with a controlling financial interest because the controlling financial interest may be achieved through arrangements that do not involve voting interests ("a variable interest entity"). AcG-15 generally requires consolidation by that entity which has variable interests that will absorb a majority of the variable interest entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both. If there is an entity that holds such majority risks and rights, that entity is defined to be the primary beneficiary of the variable interest entity. The Company has no interest in entities which meet the definition of a variable interest entity. This change in accounting has not had an impact on the Company's operating results.

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)  
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(Unaudited)

Nine months ended September 30, 2005 and 2004

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### 3. Allon Therapeutics, Inc. acquisition:

On September 28, 2004, the Company completed the acquisition of the shares of Allon USA, a biotechnology company with technology being developed for the treatment of neurological diseases and disorders. The acquisition was originally announced on June 21, 2004. The transaction has been accounted for as a business combination with the Company identified as the acquirer. The consolidated financial statements reflect the operations of Allon USA from September 28, 2004.

As consideration, the Company issued an aggregate of 9,503,457 common shares and 1,097,250 replacement options at a deemed value of \$6,148,410.

Concurrent with the acquisition of Allon USA, the Company assumed an unsecured convertible promissory note.

Details of the acquisition are as follows:

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|                                     |              |
|-------------------------------------|--------------|
| Identifiable assets acquired:       |              |
| Cash                                | \$ 1,765,473 |
| Other current assets                | 6,835        |
| Property, plant and equipment       | 2,907        |
| Technology                          | 6,643,362    |
| Licenses and patents                | 1,074,557    |
| Liabilities assumed:                |              |
| Current liabilities                 | (461,404)    |
| Convertible promissory note payable | (330,065)    |
| Future income tax liability         | (1,922,133)  |
|                                     | <hr/>        |
|                                     | \$ 6,779,532 |

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|                   |              |
|-------------------|--------------|
| Consideration:    |              |
| Common shares     | \$ 5,512,005 |
| Options           | 636,405      |
| Advance deposit   | 410,020      |
| Acquisition costs | 221,102      |
|                   | <hr/>        |
|                   | \$ 6,779,532 |

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# ALLON THERAPEUTICS INC.

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## 4. Share capital:

(a) Authorized:

Unlimited voting common shares without par value

Unlimited preferred shares, issuable in series

(b) Common shares issued and outstanding:

|   | Shares     | Amount        |
|---|------------|---------------|
| Balance December 31, 2004                     | 27,227,211 | \$ 20,766,549 |
| Shares issued pursuant to exercise of options | 50,453     | 6,647         |
| Shares issued through private placement       | 6,109,047  | 6,290,000     |
| Balance September 30, 2005                    | 33,386,711 | \$ 27,063,196 |

(c) Stock options:

The Company has reserved 4,000,000 common shares for issuance under its Stock Option Plan ("Plan"). The Plan provides for the granting of options for the purchase of common shares of the Company at the fair market value of the Company's stock at the grant date. Stock options are granted to both employees and non-employees. The Company's Board of Directors has discretion as to the number, vesting period, and expiry dates of stock options granted.

Concurrent with the acquisition of Allon USA, the Company assumed the administration of the stock option plan of Allon USA. As at September 30, 2004, 1,097,250 Company stock options were issued to former option holders of Allon USA and all Allon USA options were cancelled. The options outstanding are exercisable at a price of \$0.001 per Company Common Share and have an expiry date of May 18, 2014.

# ALLON THERAPEUTICS INC.

(Formerly Neuro Discovery Inc.)

Notes to Consolidated Financial Statements

(Unaudited)

Nine months ended September 30, 2005 and 2004

## 4. Share capital (continued):

Stock option activity from December 31, 2004 to September 30, 2005 is as follows:

|                                 | Number of<br>common<br>shares under<br>option | Weighted<br>average<br>exercise<br>price |
|---------------------------------|---|--|
| Outstanding, December 31, 2004  | 2,292,250                                     | \$ 0.59                                  |
| Granted                         | 412,500                                       | 1.00                                     |
| Exercised                       | (50,453)                                      | 0.13                                     |
| Cancelled                       | (107,500)                                     | 0.66                                     |
| Outstanding, September 30, 2005 | 2,546,797                                     | \$ 0.66                                  |
| Exercisable, September 30, 2005 | 2,046,796                                     | \$ 0.59                                  |

### (d) Warrants:

On September 28, 2004, the Company issued 4,000,000 warrants as part of an \$8.0 million dollar private placement in conjunction with the acquisition of Allon USA. In August 2005, 2,490,000 warrants were cancelled as part of the \$6.3 million private placement. Warrants were given a deemed value of \$0.05.

|                                 | Number of<br>warrants<br>outstanding | Weighted<br>average<br>exercise<br>price |
|---------------------------------|--------------------------------------|--|
| Outstanding, December 31, 2004  | 4,000,000                            | \$ 1.25                                  |
| Cancelled                       | (2,490,000)                          | 1.25                                     |
| Outstanding, September 30, 2005 | 1,510,000                            | \$ 1.25                                  |

# ALLON THERAPEUTICS INC.

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## 5. Stock-based compensation:

On March 1, 2005, the Company granted to employees, consultants and directors options to purchase 412,500 common shares of the Company at a price of \$1.00, expiring March 1, 2015. The company has recorded the fair value of the options issued as an expense in the period ended September 30, 2005. The fair value of each option granted to employees is estimated as at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield 0%, expected volatility 79%, risk free interest rate 2.96% and expected average option terms ranging from 3.0 to 5.0 years. The fair value of each option granted to non-employees is estimated as at September 30, 2005, using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield 0%, expected volatility 74%, risk free interest rate 3.32% and expected average option terms of 5.0 years.

On October 1, 2003, the Company granted to employees options to purchase 425,000 common shares of the Company at a price of \$0.40, expiring October 1, 2013. The Company has recorded the fair value of the options issued as an expense in the period ending June 30, 2005. The fair value of each option is estimated as at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield 0%, expected volatility 139%, risk free interest rate 3.2% and expected average option term of 3.0 years.

On April 3, 2002, the Company granted to employees and directors options to purchase 590,000 common shares of the Company at a price of \$1.72, expiring April 12, 2012, of which 520,000 remain outstanding. The Company has not recognized any compensation expense for stock-based compensation awarded to employees during the year ended December 31, 2002. Had compensation cost for the Company's employee stock option plan been determined based on the fair value at the grant dates for awards under this plan issued between January 1, 2002 and December 31, 2002, consistent with the current fair value based method of accounting for stock based compensation, the Company's net loss and net loss per share would have been the pro forma amounts indicated below:

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|                                     | Three months<br>ended<br>September 30,<br>2005 | Three months<br>ended<br>September 30,<br>2004 | Nine months<br>ended<br>September 30,<br>2005 | Nine months<br>ended<br>September 30,<br>2004 |
|-------------------------------------|--|--|---|---|
| Loss for the period – as reported   | \$ (1,492,248)                                 | \$ (356,098)                                   | \$ (3,957,259)                                | \$ (579,565)                                  |
| Loss for the period – pro forma     | (1,497,466)                                    | (383,581)                                      | (3,995,178)                                   | (667,123)                                     |
| Loss per common share – as reported | (0.05)   | (0.04)   | (0.14)  | (0.06)  |
| Loss per common share – pro forma   | (0.05)   | (0.04)   | (0.14)  | (0.07)  |

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# ALLON THERAPEUTICS INC.

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## 5. Stock-based compensation (continued):

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

## 6. Loss per share:

The following table sets forth the computation of loss per common share:

|   | Three months<br>ended<br>September 30,<br>2005 | Three months<br>ended<br>September 30,<br>2004 | Nine months<br>ended<br>September 30,<br>2005 | Nine months<br>ended<br>September 30,<br>2004 |
|---|--|--|---|---|
| Loss for the period                                     | \$(1,492,248)                                  | \$ (356,098)                                   | \$(3,957,259)                                 | \$ (579,565)                                  |
| Weighted average number of<br>common shares outstanding | 29,468,953                                     | 9,807,052                                      | 27,997,024                                    | 9,758,438                                     |
| Loss per common share                                   | \$ (0.05)                                      | \$ (0.04)                                      | \$ (0.14)                                     | \$ (0.06)                                     |

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## 7. Future income taxes:

As part of the acquisition of Allon USA, the Company incurred a future income tax liability for the temporary difference arising from the financial statement carrying amount of the acquired medical technology and its respective tax basis. The Company recognizes a future income tax asset to the extent of offsetting future income tax liabilities. The future income tax liability is also reduced by the tax effect of the amortization of the medical technology.

## 8. Segmented information:

Management has determined that the Company operates in one industry segment, being the development of biopharmaceutical products. Substantially all of the Company's operations, assets and employees are located in Canada and the United States.

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