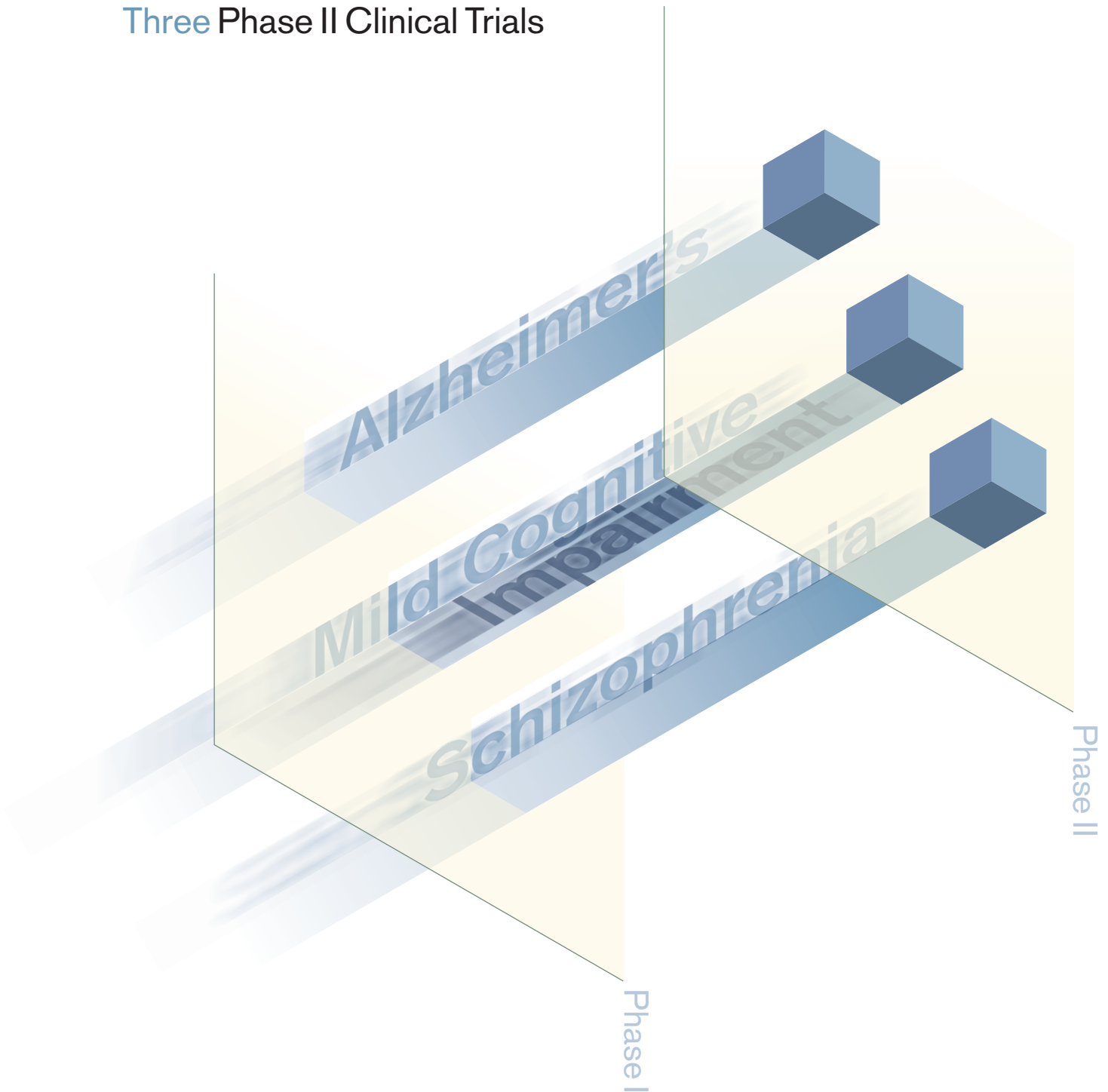


Three Phase II Clinical Trials



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## Corporate Profile

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Allon Therapeutics Inc. is a Canadian biotechnology company developing drugs that protect against neurodegenerative conditions such as Alzheimer's disease, mild cognitive impairment and schizophrenia-related cognitive impairment. Allon has two technology platforms derived from neuroprotective proteins that are formed naturally in the brain. Compounds from these two platforms have demonstrated broad efficacy in numerous pre-clinical models of neurodegenerative diseases. Allon launched two Phase II clinical trials in 2006 and began a third trial in the third quarter of 2007.

- As part of the Company's program to develop AL-108 as a disease-modifying treatment for Alzheimer's disease, a phase II trial is currently evaluating AL-108 in patients with amnesic mild cognitive impairment, a precursor to Alzheimer's.
- AL-108 is also being evaluated as a treatment for schizophrenia-related cognitive impairment, a condition considered the most significant roadblock for schizophrenia patients' return to productivity.
- AL-208 is being evaluated as a treatment for the mild cognitive impairment experienced by patients who undergo coronary artery bypass graft (MCI-CABG) surgery. The Company expects to have efficacy data from this trial in the middle of 2008.

The Company is listed on the Toronto Stock Exchange under the trading Symbol "NPC" (Neuro Protection Company) and based in Vancouver.

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## Letter to the Shareholders

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Dear Shareholders:

Your Company has continued diligently on its plan to exploit its high potential drug candidates and remains on track to release the first set of human efficacy data from our AL-108 compound in the first quarter of 2008. This efficacy data will be followed by results from two other Phase II efficacy trials over the course of 2008.

Our team has done an excellent job of executing the Phase II efficacy trial in our Alzheimer's program. In the third quarter we completed screening in this trial and subsequent to quarter end we announced completion of enrollment. It is important to note that the screen-out rate, that is the proportion of volunteers who do not actually meet the criteria we established for the trial, has been precisely what we expected. Therefore, we are confident that the subjects we enrolled are exactly the ones that we designed this trial for. In addition, to date we have seen no meaningful drop-out or adverse event trends and the numerous cognitive performance test batteries have gone as planned.

The data from this trial will be transformational for your Company. Management and our expert advisers are actively planning the subsequent studies that we anticipate in Alzheimer's in pursuit of the enormous opportunity for a therapy that can treat this unmet medical need.

Our other Phase II efficacy study with AL-108, looking at the meaningful cognitive impairment suffered by the vast majority of schizophrenia patients, began enrollment in the third quarter and is progressing well. This trial is being conducted in collaboration with the National Institutes of Health Funded group Treatment Units for Research on Neurocognition in Schizophrenia (TURN) and the National Association for Research in Schizophrenia and Related Disorders (NARSAD), and we expect it to conclude toward the end of 2008.

The third Phase II efficacy trial is with our compound AL-208 and is focused on the mild cognitive impairment suffered by many patients after heart bypass surgery. This study is enrolling more slowly than we anticipated and we have taken various measures to improve that enrollment. We expect data from this trial in the middle of 2008.

Our pre-clinical programs are advancing well and we expect to clarify publicly our plans with respect to these products before the end of this year.

All other elements of our business are progressing as planned. In particular, we were pleased to welcome a new Vice-President of Business Development in the quarter. Dr. Annette Kleiser has impressive credentials in pharmaceutical partnering and will be an invaluable asset as we get even deeper into discussions with prospective Pharma partners.

Respectfully,

*"Gordon McCauley"*

Gordon C. McCauley  
President & CEO

# FINANCIAL INFORMATION

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## MANAGEMENT'S DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2007

*The following information should be read in conjunction with the 2006 audited consolidated financial statements, their accompanying notes and management's discussion and analysis for the year ended December 31, 2006 included in our Annual report (2006 Annual Report) as well as related notes for the Company for the third quarter (Q3 2007) and year-to-date (YTD) operations ended September 30, 2007. 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 09, 2007

## OVERVIEW

Allon Therapeutics Inc. is a clinical-stage Canadian biotechnology company developing drugs that protect against neurodegenerative conditions which impact the body's central nervous system. Allon has three Phase II clinical programs in Alzheimer's disease (AD), schizophrenia-related cognitive impairment and mild cognitive impairment associated with coronary artery bypass graft (MCI-CABG) surgery. Allon is listed on the Toronto Stock Exchange under the trading symbol "NPC" (Neuro Protection Company<sup>TM</sup>) and based in Vancouver.

Allon's compounds come from two technology platforms, activity dependent neuroprotective protein (ADNP) and activity dependent neurotrophic factor (ADNF) which are neuroprotective proteins that are formed naturally in the brain. Allon's compounds are derived from either ADNP or ADNF and have demonstrated broad efficacy in numerous pre-clinical models of neurodegenerative diseases. Allon's clinical drug compounds, AL-108 and AL-208, are both derived from the ADNP platform as is preclinical candidate AL-408. Two additional preclinical compounds, AL-309 and AL-209, are derived from the ADNF platform.

The following table summarizes the development status of each of our research and development programs:

Platform	Compound	Stage of Development	Status
ADNP	AL-108	Phase II Clinical Trial Alzheimer's	Patient screening completed Q3 2007 (enrollment completed Q4 2007)
	AL-108	Phase II Clinical Trial Schizophrenia-related cognitive impairment	Enrollment initiated Q3 2007

	AL-208	Phase II Clinical Trial Mild cognitive impairment associated with coronary artery bypass graft (MCI-CABG) surgery	Completed open label safety portion, randomized portion initiated Q1 2007
	AL-408	Pre-clinical Stage	Pre-clinical pharmacology studies ongoing
ADNF	AL-309	Pre-clinical Stage	Pre-clinical studies commenced Q2 2007, confirmed oral and brain bioavailability
	AL-209	Pre-clinical Stage	Pre-clinical pharmacology studies ongoing

## THIRD QUARTER 2007 ACHIEVEMENTS

During the third quarter of 2007, the following significant events occurred:

- Completed patient screening for the Phase II human efficacy trial in Alzheimer's and subsequent to quarter end announced completion of enrollment;
- Commenced patient enrollment in the Phase II schizophrenia-related cognitive impairment trial;
- Proceeding with the randomized portion of patient enrollment for the Phase II human efficacy trial in MCI-CABG;
- Advanced pre-clinical studies and confirmed the brain bioavailability of AL-309;
- Allon's Alzheimer's program was selected as one of the top 10 not yet partnered biotech programs in the world; and
- Strengthened Allon's management team with the hiring of VP, Business Development, Annette Kleiser.

## RESULTS OF OPERATIONS

For the three months ended September 30, 2007, Allon reported a net loss of \$3,242,315 (\$0.05 per share) compared to a net loss of \$1,975,807 (\$0.06 per share) for the three months ended September 30, 2006 (Q3 2006). For the nine months ended September 30, 2007 (YTD 2007), Allon reported a net loss of \$8,612,351 (\$0.17 per share) compared to a net loss of \$5,604,981 (\$0.17 per share) for the nine months ended September 30, 2006 (YTD 2006).

The most significant factor contributing to the increased loss during the quarter and YTD was research and development expenses associated with the advancement of Allon's three Phase II clinical trials.

## EXPENSES

### RESEARCH AND DEVELOPMENT

For the three month period ended September 30, 2007, research and development expenses were \$2,118,261 compared to \$1,471,652 in Q3 2006. The YTD 2007 research and development expenses were \$5,720,051 compared to \$3,862,493 for the comparable period in 2007.

During the quarter ended September 30, 2007, Allon achieved a number of significant milestones in its three ongoing Phase II clinical trials including the completion of patient screening in the AL-108 Alzheimer's trial and initiation of enrollment in the AL-108 schizophrenia-related cognitive impairment trial. The Company also continued pre-clinical studies to advance its other pipeline products, most notably AL-309. During the comparable three month period ended September 30, 2006, Allon's focus was Phase I safety studies for AL-108, the advancement of patient enrollment for the open label safety portion for the AL-208 Phase II human efficacy trial in MCI-CABG and preparatory work for the AL-108 Phase II clinical trials currently in process.

During the nine months ended September 30, 2007, Allon significantly advanced its Phase II clinical trials towards delivery of human efficacy data in 2008 by completing patient screening in the AL-108 Alzheimer's trial, initiating enrollment in the Phase II schizophrenia-related cognitive impairment trial, and commencing and advancing the randomized portion for the AL-208 trial in MCI-CABG. Allon also commenced pre-clinical research of AL-108 for Parkinson's disease, funded by the Michael J. Fox foundation, and advanced pre-clinical studies, confirming both oral and brain bioavailability for its AL-309 compound.

During the comparable nine month period ended September 30, 2006, Allon conducted pre-clinical and Phase I studies to confirm the safety and tolerability of AL-108 as a treatment for Alzheimer's and incurred expenses for the preparation of the AL-108 Phase II human efficacy trial in Alzheimer's. Allon completed a Phase I study to confirm safety of multiple doses of AL-208 and initiated patient enrollment in the open label portion of the AL-208 Phase II human efficacy trial in MCI-CABG.

### **Clinical stage compounds:**

#### **AL-108**

AL-108 is an intranasally formulated, eight amino acid neuroprotective peptide from the ADNP platform. Allon currently has two Phase II clinical trials underway, evaluating AL-108 as a treatment for Alzheimer's disease and schizophrenia-related cognitive impairment. Development costs for AL-108 accounted for \$929,000 of the Company's Q3 2007 expenses and \$2.8 million year-to-date.

#### *Alzheimer's disease*

During Q3 2007 Allon completed patient screening for the Phase II human efficacy trial in Alzheimer's disease and subsequent to the quarter announced that the Company had completed patient enrollment. During the trial, multiple, doses of AL-108 are intranasally administered over a 12-week period to patients, aged 55 to 85 years, with amnesic MCI, a precursor to Alzheimer's disease. Patients who received AL-108 are compared against a control group to determine efficacy based on cognitive measures taken over a 20 week period starting 4 weeks before a patient receives AL-108

and ending 4 weeks post treatment. Results of the Phase II trial will be evaluated for safety, tolerability and effect on cognitive function. Based on progress to date management anticipates that the results will support further clinical development in Alzheimer's and MCI and is actively planning subsequent studies. Allon expects to release results in Q1 2008.

Year-to-date, Allon also released results from the AL-108 Phase Ib clinical trial confirming that AL-108 was safe and well tolerated in healthy, elderly adults after seven days of dosing. Results also validated the pharmacokinetic profile of AL-108 to support long-term use as well as confirm the doses selected for the Phase II clinical trials.

### *Schizophrenia-related cognitive impairment*

During Q3 2007 patient enrollment commenced for the Phase II clinical trial to evaluate AL-108 as a treatment for schizophrenia-related cognitive impairment. The clinical trial is being funded and conducted by the National Institute of Mental Health – funded project Treatment Units for Research on Neurocognition and Schizophrenia (TURNS) in collaboration with Allon. Sixty patients will be enrolled and receive daily doses of AL-108 over a period of 12 weeks following which cognition will be assessed against a control group.

Year-to-date, Allon successfully filed an IND application, made active by the FDA in Q2 2007, to allow the Company to proceed with the Phase II clinical trial.

### **AL-208**

AL-208 is an intravenously delivered, eight amino acid peptide also from the ADNP platform currently in a Phase II clinical trial for MCI-CABG. Expenditures on the AL-208 program accounted for \$639,000 of Allon's current quarter and \$1.5 million of year-to-date research and development expenses based on the progress outlined below.

During the quarter, Allon continued enrolling patients in the randomized portion of the Phase II clinical trial and took steps to increase the rate of patient enrollment including minor changes to the trial design and addition of new clinical sites.

Year-to-date, Allon successfully completed the open label safety portion, commenced and advanced enrollment in the randomized portion of this clinical trial. In total, approximately 200 patients will be treated with AL-208 (or placebo) during surgery. The patients will be assessed using standard cognitive tests, administered several weeks after surgery, to determine the impact on cognitive function of patients treated with AL-208 versus patients in the control group. The trial is being conducted in hospitals in the US and Canada. Allon expects the results of this trial will support further clinical development in MCI-CABG and potentially other acute neurodegenerative diseases such as stroke and traumatic brain injury.

### **Pre-clinical stage compounds:**

#### **AL-309**

AL-309 is a D-amino acid derivative of AL-209 from the ADNF platform that has shown oral bioavailability, a property that may provide alternative opportunities for chronic daily dosing. AL-309 has demonstrated efficacy in animal models related to Alzheimer's disease, neuropathy and fetal alcohol syndrome.

During Q3 2007, Allon advanced pharmacology, pharmacokinetic and preliminary toxicology studies.

Year-to-date, Allon released pre-clinical study data confirming that AL-309 enters the brain and that effective concentrations can be detected for extended periods of time. Allon has selected AL-309 as the next drug candidate for clinical development, anticipated to begin early in 2008.

### **AL-209**

AL-209 is a nine amino acid peptide that has demonstrated potent neuroprotective effects in a number of neurodegenerative disease models such as Alzheimer's disease, fetal alcohol syndrome and amyotrophic lateral sclerosis (ALS). The product is currently in pre-clinical development.

### **AL-408**

AL-408 is a D-amino acid derivative of AL-108. It has demonstrated neuroprotective effects in neurodegenerative animal models of Alzheimer's disease and fetal alcohol syndrome. Furthermore, the compound has also shown to be orally bioavailable, which makes it a potential drug candidate for chronic neurodegenerative disease indications.

## **GENERAL AND ADMINISTRATIVE**

For the three month period ended September 30, 2007, general and administrative expenses were \$529,214 compared to \$392,279 in Q3 2006. Year-to-date general and administrative expenses were \$1,669,378 compared to \$1,377,110 for the same period 2006. Quarter over quarter expenses increased by \$136,935 while year-to-date 2007 expenses increased by \$292,268 over the same period 2006. The quarter and year-to-date increases result from expanded business development activities, investor relations initiatives and recruitment of additional personnel.

## **AMORTIZATION**

Amortization expense for the three month period ended September 30, 2007 was \$136,416 compared to \$135,990 in Q3 2006. Year-to-date amortization was \$409,415 compared to \$427,145. The year-to-date \$17,730 decrease from the same period 2006 primarily resulted from a one-time adjustment of \$23,092 to amortization expense during Q1 2006. The adjustment occurred due to change in method used to account for depreciation of property, plant and equipment from declining balance to straight line. The change in method resulted from a change in the accounting estimate of the salvage value of depreciable tangible assets and was accounted for prospectively. The Company does not expect the change in estimate to have a material impact in future periods.

## **OTHER EXPENSE/(INCOME)**

For the three month period ended September 30, 2007, the Company incurred other expenses of \$458,424 compared to other income of \$24,114 in Q3 2006. Year-to-date, the Company incurred other expenses of \$813,507 compared to \$87,770 for the same period 2006. The most significant factors contributing to the \$482,538 and \$725,737 increased quarter over quarter and year-to-date expenses are increased foreign exchange loss on translation of US balances to Canadian dollars, partly offset by increased interest earned on cash reserves.

The Company earned interest and other income of \$239,526 and \$485,612 during the three and nine month periods ended September 30, 2007 compared to \$66,470 and \$203,570 for the same periods 2006. Higher interest revenues are attributed to increased cash and short-term investment balances resulting from the \$15.7 million equity financing Allon completed during Q2 2007. Other income, detailed further in Significant Accounting Policies under Section 2 of the financial statements results from the adoption of financial instruments on January 1, 2007.

Foreign exchange translation losses were \$650,247 and \$1,091,306 for the respective three and nine month periods ended September 30, 2007 compared to a gain of \$6,783 and loss of \$140,954 for the same periods 2006. The increased losses primarily resulted from the strengthening of the Canadian dollar relative to the US dollar which impacts the translation of US dollar balances to Canadian dollars. The Company's policy is to maintain sufficient US denominated cash, cash equivalent and short-term investment balances to match its anticipated US dollar operating expenses Foreign exchange losses are detailed further under Financial Risk. Stock based compensation expenses were \$53,679 and \$208,925 during the respective three and nine month periods ended September 30, 2007 compared to \$49,909 and \$149,560 for the same periods last year. The increased expense is the result of the vesting of options issued in prior years to new and existing employees and directors in accordance with Allon's compensation policy. During Q3 2007, the Company recorded a \$5,976 unrealized gain when it fair valued short-term investments, representing an increase of \$5,206 from the Q3 2006 realized gain of \$770 on the early redemption of short-term investments. The year-to-date gain of \$1,112 results from fair valuing short-term investments, partly offset by losses on early redemption compared to a loss of \$826 incurred for early redemption of short-term investments for the same period 2006.

## 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, 2007</b>	<b>Jun 30, 2007</b>	<b>Mar 31, 2007</b>	<b>Dec 31, 2006</b>
Interest income	\$ 240	\$ 131	\$ 109	\$ 65
Research and development expenses	\$ 2,118	\$ 1,540	\$ 2,062	\$ 2,859
Loss for the quarter	\$ (3,242)	\$ (2,552)	\$ (2,819)	\$ (3,579)
Loss per share	\$ (0.05)	\$ (0.05)	\$ (0.06)	\$ (0.09)
	<b>Sept 30, 2006</b>	<b>Jun 30, 2006</b>	<b>Mar 31, 2006</b>	<b>Dec 31, 2005</b>
Interest income	\$ 66	\$ 59	\$ 78	\$ 75
Research and development expenses	\$ 1,472	\$ 1,216	\$ 1,175	\$ 1,841
Loss before tax recovery	\$ (1,976)	\$ (1,984)	\$ (1,794)	\$ (2,271)
Future income tax recovery	-	-	\$ 149	\$ 679
Loss for the quarter	\$ (1,976)	\$ (1,984)	\$ (1,645)	\$ (1,592)
Loss per share	\$ (0.06)	\$ (0.06)	\$ (0.05)	\$ (0.05)

During the quarter ended December 31, 2005, the Company completed dosing in its Phase I clinical study for AL-208 as a treatment for MCI associated with CABG. Eight dose groups including healthy adults and healthy elderly adults were dosed, intravenously. The Company also conducted further pre-clinical work to add to the extensive body of research underlying its human clinical development program and to obtain data for the next stage of drug development. Animal studies confirmed that both AL-108 and AL-208 penetrate the blood brain barrier and rapidly reach their target therapeutic areas in the central nervous system.

During the first quarter of 2006, the Company announced the results of its AL-208 Phase I clinical trial for which dosing was completed in Q4 2005. Results demonstrated that AL-208 was safe and well tolerated by all study participants. During the quarter, Allon expanded the AL-208 development program by commencing a Phase Ib multiple ascending dose clinical trial, to test the drug as a treatment for neurodegenerative diseases requiring multiple doses. This trial commenced on March 27, 2006. The Company also completed additional pre-clinical work to support the clinical development for its AL-108 product, being developed as a treatment for Alzheimer's disease.

During the quarter ended June 30, 2006, Allon completed dosing for its AL-208 Phase Ib multiple ascending dose clinical trial, initiated in Q1 2006, and began patient enrollment for a Phase II clinical trial for AL-208 indicated for MCI post-CABG. The Company completed preparatory work for a Phase Ib multiple ascending dose clinical trial for AL-108, indicated for Alzheimer's disease and scheduled to commence in Q3 2006.

During the quarter ended September 30, 2006, Allon incurred the final expenses for its Phase Ib clinical trial of AL-208 and continued enrollment in the safety portion of its Phase II clinical trial for AL-208. The Company initiated a Phase 1b multiple-ascending dose clinical trial for AL-108 to evaluate its safety and tolerability as a treatment for Alzheimer's disease. Subsequent to the end of the quarter, on November 1, 2006 the Company announced that dosing was completed. Allon also incurred expenses in preparation for a Phase II clinical trial of AL-108, expected to begin in the fourth quarter of 2006.

During the quarter ended December 31, 2006, Allon completed dosing for a Phase Ib multiple, ascending dose clinical trial of AL-108 and completed dosing for the safety portion of a Phase II clinical trial for AL-208 indicated for MCI post-CABG. Allon filed an IND, received approval and began a Phase II clinical trial of AL-108, indicated for MCI, an Alzheimer's related condition. The Company also completed a \$10.0 million equity financing.

During the quarter ended March 31, 2007, Allon commenced patient enrollment for its Phase II trial of AL-108 indicated for Alzheimer's and filed an IND which will allow the Company to proceed in a Phase II clinical trial to evaluate AL-108 as a treatment for schizophrenia-related cognitive impairment. Allon released results from the AL-108 Phase Ib clinical trial confirming that administrations of multiple doses of AL-108 were safe and well tolerated in healthy, elderly adults. On completion of the safety portion of the AL-208 Phase II MCI-post-CABG Allon commenced enrollment for the randomized portion of the study.

During the quarter ended June 30, 2007 Allon continued to advance its AL-108 and AL-208 Phase II human efficacy trials and continued preparations for its Phase II clinical trial of AL-108 for schizophrenia-related cognitive impairment. This trial is expected to commence in the United States during Q3 2007. Allon confirmed the oral bioavailability of its AL-309 drug compound which has shown potential as a treatment for chronic central nervous system diseases and injuries. The Company also completed a \$15.7 million bought deal equity financing.

During the quarter ended September 30, 2007 Allon significantly advanced its Phase II clinical programs towards delivery of human efficacy data in 2008. Allon completed patient screening for the AL-108 Phase II human efficacy trial in Alzheimer's and announced completion of enrollment subsequent to the end of the quarter. Allon continued its collaboration with the NIMH funded project TURNS and NARSAD, marked by the commencement of patient enrollment in the Phase II trial for AL-108 in schizophrenia-related cognitive impairment. The Company continued enrolling patients and made minor changes to the trial design intended to improve the rate of enrollment for its Phase II human efficacy trial for AL-208 in MCI-CABG. Further, Allon advanced pre-clinical work on its AL-309 compound.

## **LIQUIDITY**

At September 30, 2007 the Company had cash and short-term investments of \$16,660,146 compared to \$10,369,753 at December 31, 2006. Short-term investments are held in high-grade, liquid commercial paper and other low risk investments which are recorded at fair value. The Company has no exposure to liquidity or other risks associated with certain Asset-Backed Securities. At September 30, 2007 maturities on investments ranged from 30 days to 5 months.

During the quarter ended June 30, 2007 Allon completed a bought deal financing, issuing 13,059,933 units (the "Units"), comprised of one share and one half share purchase warrant at a price of \$1.20 per Unit. An additional 103,699.5 warrants were also purchased as part of the transaction resulting in gross proceeds of \$15.7 million. Each whole warrant will entitle the holder thereof to purchase one common share at an exercise price of \$1.65 for a term of 24 months. Allon expects cash on hand and interest revenue to fund operations to the middle of 2009.

The Company has 2.5 million stock options exercisable at prices ranging from \$.001 to \$1.72 per share and 12.9 million warrants outstanding and exercisable at prices ranging from \$1.00 to \$1.65. If all outstanding stock options and warrants were exercised, proceeds of \$1.6 million and \$17.2 million would be generated respectively.

## **CAPITAL RESOURCES**

The Company had working capital of \$15.9 million at September 30, 2007, an increase of \$6.5 million from December 31, 2006. The increased working capital results from the completion of the bought deal equity financing that increased cash reserves by \$14.5 million, partly offset by costs associated with ongoing enrollment for the AL-108 and AL-208 Phase II clinical trials.

With the continued advancement of two of its drug programs in three Phase II clinical trials, Allon has entered into contracts that will remain in effect over several reporting periods. These contracts are performance based with payment subject to the achievement of clinical trial milestones and may be cancelled with written notice.

The Company believes that its cash and short-term investments as at September 30, 2007 and expected interest income will be sufficient to fund operations and commitments to the middle of 2009.

## **OUTSTANDING SHARE CAPITAL**

At September 30, 2007, the Company had 58,997,269 common shares outstanding. Each common share entitles the holder to one vote per share. At September 30, 2007, the Company had 3,848,497 options outstanding, of which 2,510,497 were exercisable into an equivalent number of the Company's common shares at exercise prices ranging from \$0.001 to \$1.72. See Note 4 of the Company's financial statements for more detail regarding outstanding share capital.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

On January 1, 2007, the Company prospectively adopted new financial reporting standards relating to the recognition and measurement as well as disclosure and presentation of comprehensive income, financial instruments and equity. The Company's estimates have not changed from 2006. The Company's 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 2006 Annual Report and Significant Accounting Policies section of its First Quarter Report.

## **RISKS AND UNCERTAINTIES**

As previously described, the Company believes that cash on hand, together with expected interest income will be sufficient to fund operations to the middle of 2009. 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 2006 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).

## **FINANCIAL RISK**

Allon is exposed to financial risk arising from fluctuations in foreign exchange and interest rates and the degree of volatility of these rates. The Company's policy is to maintain sufficient US denominated cash, cash equivalent and short-term investment balances to meet its future operating needs. The Company is therefore subject to foreign exchange risk as a significant portion of its cash, cash equivalents and short-term investments are denominated in US dollars. The net foreign exchange gains and losses were primarily the result of changes in the relationship of the U.S. to Canadian dollar exchange rates when translating U.S. denominated cash, cash equivalents and short-term investments to Canadian dollars for reporting purposes at period end. Allon has not entered into any speculative forward currency contracts or other financial derivatives for trading purposes or to hedge foreign exchange risk, and therefore is subject to foreign currency transaction and translation gains and losses. The Company purchases goods and services in U.S. and Canadian dollars. Foreign exchange risk is managed primarily by satisfying foreign denominated expenditures with cash flows or assets denominated in the same currency.

Interest rate risk arises from investment of the Company's cash and cash equivalents and short-term investments invested in fixed rate securities which are classed as held-for-trading, recorded at fair value and subject to fluctuations in market value prior to maturity. The Company mitigates interest rate risk by holding most investments to maturity.

## **DISCLOSURE CONTROLS AND PROCEDURES**

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in filings made pursuant to Multilateral Instrument 52-109 is recorded, processed, summarized and reported within the time periods specified in the Canadian Securities Administrators' rules and forms.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007 and concluded that they provide reasonable assurance that material information relating to the Company was made known to them and reported as required.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Company has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in compliance with Canadian generally accepted accounting principles.

Allon's Chief Executive Officer and Chief Financial Officer are also responsible for the design of internal controls required in order to provide reasonable assurance that processes used for preparation of financial statements and financial reporting for external purposes are reliable and in accordance with Canadian GAAP. They have evaluated the design of our internal controls and procedures over financial reporting as of the end of the period covered by the annual filings, and believe the design to be sufficient to provide such reasonable assurance.

Regardless of how well an internal control system is designed and operated, it can provide only reasonable, not absolute, assurance that it will prevent or detect all misstatements, due to error or fraud, from occurring in the financial statements due to the inherent limitations of any internal control system.

There were no changes in the Company's internal controls over financial reporting that occurred during the three months ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

# ALLON THERAPEUTICS INC.

## Consolidated Balance Sheets

	September 30, 2007	December 31, 2006
	(unaudited)	(audited)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 9,294,440	\$ 10,369,753
Short-term investments	7,365,706	-
Accounts receivable (note 7)	95,130	202,854
Prepaid expenses and deposits	309,104	251,531
	<u>17,064,380</u>	<u>10,824,138</u>
Long term receivable (note 7)	-	21,180
Property and equipment	45,635	57,535
Intangible assets	6,180,773	6,564,591
	<u>6,226,408</u>	<u>6,643,306</u>
	<u>\$ 23,290,788</u>	<u>\$ 17,467,444</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Unearned revenue (note 3)	\$ 114,166	\$ -
Accounts payable and accrued liabilities	1,098,476	1,429,588
	<u>1,212,642</u>	<u>1,429,588</u>
Shareholders' equity:		
Share capital (note 4)	50,832,485	36,402,236
Additional paid-in capital	1,313,529	1,091,137
Deficit	(30,067,868)	(21,455,517)
	<u>22,078,146</u>	<u>16,037,856</u>
	<u>\$ 23,290,788</u>	<u>\$ 17,467,444</u>

Basis of presentation (note 1)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

*"Frank A. Holler"*

Frank A. Holler  
Director

*"C. Michael O'Brian"*

C. Michael O'Brian  
Director

# ALLON THERAPEUTICS INC.

Consolidated Statements of Operations and Comprehensive Loss  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
<b>Expenses:</b>				
Research and development	\$ 2,118,261	\$ 1,471,652	\$ 5,720,051	\$ 3,862,493
General and administrative	529,214	392,279	1,669,378	1,377,110
Amortization	136,416	135,990	409,415	427,145
	<u>2,783,891</u>	<u>1,999,921</u>	<u>7,798,844</u>	<u>5,666,748</u>
<b>Other expense/(income):</b>				
Interest and other income	(239,526)	(66,470)	(485,612)	(203,570)
Foreign exchange loss/(gain)	650,247	(6,783)	1,091,306	140,954
Stock-based compensation (note 5)	53,679	49,909	208,925	149,560
Loss/Gain on short-term investments	(5,976)	(770)	(1,112)	826
	<u>458,424</u>	<u>(24,114)</u>	<u>813,507</u>	<u>87,770</u>
Loss before income taxes	(3,242,315)	(1,975,807)	(8,612,351)	(5,754,518)
Future income tax recovery	-	-	-	149,537
Net and Comprehensive loss for the period	(3,242,315)	(1,975,807)	(8,612,351)	(5,604,981)
Deficit, beginning of period	(26,825,553)	(15,900,640)	(21,455,517)	(12,271,466)
Deficit, end of period	<u>\$(30,067,868)</u>	<u>\$(17,876,447)</u>	<u>\$(30,068,868)</u>	<u>\$(17,876,447)</u>
<b>Net loss per common share:</b>				
Basic and diluted (note 6)	\$ (0.05)	\$ (0.06)	\$ (0.17)	\$ (0.17)

See accompanying notes to interim consolidated financial statements.

# ALLON THERAPEUTICS INC.

Consolidated Statements of Cash Flows  
(Unaudited)

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Cash flows provided by (used in):				
Operations:				
Loss for the period	\$(3,242,315)	\$(1,975,807)	\$(8,612,351)	\$(5,604,981)
Items not involving cash:				
Amortization	136,416	135,990	409,415	427,145
Stock-based compensation	53,679	49,909	208,925	149,560
Future income tax recovery	-	-	-	(149,537)
Unrealized (loss)/gain on short-term investments	(5,976)	-	(1,112)	-
Change in non-cash operating working capital	516,516	481,091	(144,502)	(559,466)
	(2,541,680)	(1,308,817)	(8,139,625)	(5,737,279)
Investments:				
Sale/(purchase) of short-term investments	7,883,332	2,892,148	(7,365,706)	8,052,142
Purchase of property, plant and equipment	(7,726)	(3,944)	(13,698)	(26,746)
	7,875,606	2,888,204	(7,379,404)	8,025,396
Financing:				
Repayment of bank debt	-	-	-	(25,466)
Proceeds from issuance of common shares, net of share issue costs	(34,264)	-	14,443,716	-
	(34,264)	-	14,443,716	(25,466)
Increase/(decrease) in cash and cash equivalents for the period	5,299,662	1,579,387	(1,075,313)	2,262,651
Cash and cash equivalents, beginning of period	3,994,778	683,264	10,369,753	-
Cash and cash equivalents, end of period	\$ 9,294,440	\$ 2,262,651	\$ 9,294,440	\$ 2,262,651
Supplementary information:				
Cash received during the year for:				
Interest	\$ 146,901	\$ 97,788	\$ 289,922	\$ 283,107
Income taxes recovered	-	-	-	\$ 149,537

See accompanying notes to interim consolidated financial statements.

# ALLON THERAPEUTICS INC.

## Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

Nine months ended September 30, 2007 and 2006

	Share Capital		Additional Paid In Capital	Accumulated Deficit	Total Shareholders Equity
	Number	Value			
Balance at December 31, 2005	33,386,711	\$27,025,231	\$893,475	\$(12,271,466)	\$15,647,240
Stock based compensation			149,560		149,560
Net loss for the period				(5,604,981)	(5,604,981)
Balance at September 30, 2006	33,386,711	\$27,025,231	\$1,043,035	\$(17,876,447)	\$10,191,819

	Share Capital		Additional Paid In Capital	Accumulated Deficit	Total Shareholders Equity
	Number	Value			
Balance at December 31, 2006	45,911,711	\$36,402,236	\$1,091,137	\$(21,455,517)	\$16,037,856
Shares issued pursuant to bought deal	13,059,933	15,671,920			15,671,920
Warrants issued pursuant to bought deal			16,592		16,592
Shares issued pursuant to options exercised	10,000	7,125	3,125		4,000
Shares issued pursuant to warrants exercised	15,625	15,625			15,625
Share issue costs, financing		(1,264,421)			(1,264,421)
Stock based compensation					
Contractors			56,461		56,461
Employees			152,464		152,464
Net loss for the period				(8,612,351)	(8,612,351)
Balance at September 30, 2007	58,997,269	\$50,832,485	\$1,313,529	\$(30,067,868)	\$22,078,146

See accompanying notes to interim consolidated financial statements.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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## 1. Basis of presentation:

Allon Therapeutics Inc. ("Allon" or the "Company") 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.

The eventual profitability of the Company and its ability to continue as a going concern is dependent upon many factors, obtaining appropriate financing as required, successful development of its products, and receiving regulatory approvals. In addition, the biotechnology industry is subject to rapid and substantial technological change which could reduce the marketability of the Company's technology. The Company will be required to obtain additional sources of financing in order to continue its research activities, its issuance and maintenance of patents, realize returns on its assets and discharge its liabilities in the normal course of business.

## 2. Significant accounting policies:

These unaudited interim consolidated financial statements are prepared following accounting policies and methods of their application consistent with the Company's audited annual financial statements and notes for the year ended December 31, 2006 except as described in note 2(a) to 2(c) below. These unaudited interim consolidated financial statements do not include all note disclosures required by Canadian generally accepted accounting principles ("Canadian GAAP") for annual financial statements, and therefore should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2006 included in the Company's 2006 Annual Report. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results for the full year.

### (a) Accounting changes:

In July 2006, the Accounting Standards Board ("AcSB") issued a replacement of The Canadian Institute of Chartered Accountants' Handbook ("CICA Handbook") section 1506, Accounting Changes ("Section 1506"). The new standard allows for voluntary changes in accounting policy only when changes result in the financial statements providing reliable and more relevant information. The standard requires changes in accounting policy to be applied retrospectively unless doing so is impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. The impact that the adoption of section 1506 will have on the Company's results of operations and financial condition will depend on the nature of future accounting changes. The adoption of Section 1506 effective January 1, 2007 has had no material impact on these unaudited interim consolidated financial statements.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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(b) Financial instruments:

Effective January 1, 2007, the Company prospectively adopted the new recommendations of the CICA Handbook Section 1530, Comprehensive Income ("Section 1530"); Section 3855, Financial Instruments – Recognition and Measurement ("Section 3855"); Section 3861, Financial Instruments – Disclosure and Presentation ("Section 3861"); Section 3251, Equity ("Section 3251"); Section 3865, Hedges ("Section 3865"). These sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP. The adoption of these Handbook Sections had no impact on opening deficit.

- (i) Under Section 3855, financial instruments must be classified into one of five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. All financial instruments, including derivatives, are measured on the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and accounting for changes in fair value will depend on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income.

Upon adoption of these new standards, the Company designated its cash, cash equivalents and short-term investments as held-for-trading and therefore measured these assets at fair value. The effect of the accounting change was an unrealized gain of \$5,959 and \$1,112 on short-term investments for the three and nine month periods ended September 30, 2007, respectively. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities.

Section 3855 requires that the Company identify embedded derivatives that require separation from the related host contract and measure those embedded derivatives at fair value. Subsequent changes in fair value of embedded derivatives are recognized in the consolidated statement of operations and comprehensive loss in the period the change occurs.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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The Company identified and measured all embedded derivatives that required separation and determined the fair value of those embedded derivatives at January 1, 2007 through September 30, 2007. The effect of the accounting change was other income gains of \$16,680 and \$22,866 for the respective three and nine month periods ended September 30, 2007.

- (ii) Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. This Section requires an enterprise to present a separate component of equity for each category of equity that is of a different nature, including the separation of net income, other comprehensive income, other changes in retained earnings, changes in contributed surplus, changes in share capital, and changes in reserves. For the three and nine months ended September 30, 2007, there were no additional items requiring separate disclosure.

(c) Non-monetary transactions:

Effective January 1, 2007, the Company adopted the new recommendations of CICA Handbook Section 3831, Non-monetary Transactions prospectively. The purpose is to disclose information that enables users of the financial statements to understand the effects of a non-monetary transaction on the financial statements. This standard requires all non-monetary transactions be measured at their fair value unless: the transaction lacks commercial substance; the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange; neither the fair value of the asset received nor the fair value of the asset given up is reliably measurable; or the transaction is a non-monetary non-reciprocal transfer to owners. The adoption of this standard had no impact on the Company's interim consolidated financial statements.

### 3. Unearned revenue:

On January 24, 2007 the Company announced that it received a grant from The Michael J. Fox Foundation for Parkinson's Research ("MJFF") to evaluate the effectiveness of AL-108 in pre-clinical models of Parkinson's disease. Allon received \$102,412 and \$214,289 during the respective three and nine month periods ended September 30, 2007. The unused balance of \$114,166 was recorded as unearned revenue at September 30, 2007 and is to be applied against future research expenses as incurred. Any amounts not used within one year of the grant date are to be repaid to MJFF. The Company anticipates using the total amount of the grant.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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## 4. Share capital:

(a) Authorized:

Unlimited voting common shares without par value

Unlimited preferred shares, issuable in series

(b) Equity Financing:

On May 29 and June 22, 2007, Allon closed a bought deal equity financing. The financing consisted of 13,059,933 units (the "Units"), comprised of one share and one half share purchase warrant priced at \$1.20 per Unit and 103,699.5 warrants priced at \$0.16 per whole warrant for total gross proceeds of \$15,688,512 less issue costs of \$1,264,421 for net proceeds of \$14,424,091.

(c) A total of 6,633,666 share purchase warrants were issued in conjunction with the Q2 2007 equity financing. Each whole warrant will entitle the holder thereof to purchase one common share at an exercise price of \$1.65 for a term of 24 months following the date of issue. The amount received for the 103,699.5 warrants of \$16,592 approximates the fair value of the warrants and is recorded as additional paid in capital.

As of September 30, 2007 the Company had warrants outstanding to acquire 12,880,541 common shares at prices ranging from \$1.00 to 1.65 which would result in proceeds of \$17,192,424 if they were exercised in full.

## 5. Stock-based compensation:

The Company recognized \$53,679 and \$208,925 in compensation expense for the three and nine months ended September 30, 2007 respectively (\$49,909 and \$149,560 for the three and nine months ended September 30, 2006 respectively) relating to awards granted to employees and non-employees under its stock option plan.

Stock options:

The Company Stock Option 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.

The Plan is based on a rolling percentage of options issuable of up to 10% of the Company's outstanding common shares. As of September 30, 2007, the Company had 58,997,269 common shares issued and outstanding resulting in current authorization to issue a maximum of 5,899,727 options under the Plan.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

During the nine months ended September 30, 2007, the Company granted 150,000 options with terms of ten years. The options entitle holders to purchase common shares of the Company at prices ranging from \$1.00 to \$1.12 per share.

Stock option activity from December 31, 2006 to September 30, 2007 is as follows:

	# of common shares under option	Weighted avg exercise price
Outstanding, December 31, 2006	3,708,497	\$ 0.76
Granted	150,000	1.08
Exercised	(10,000)	0.40
Cancelled	-	-
Outstanding, September 30, 2007	3,848,497	\$ 0.77
Exercisable, September 30, 2007	2,510,497	\$ 0.64

The fair value of share based awards is determined using the Black-Scholes option pricing model. Like other accepted option valuation models, the Black-Scholes model 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. The Black-Scholes option pricing model is also based on several highly subjective assumptions including the expected life of the option, expected future stock price volatility and fair value of the Company's stock at the date of grant of the stock options. Changes in these assumptions can materially affect the estimated fair value of the Company's stock options.

The estimated fair value of options granted to the Company's employees and directors after 2002 is calculated at the grant date and amortized on a straight line basis over the vesting period of the options. The Black-Scholes option-pricing model was used with the following weighted-average assumptions for the nine months ended September 30, 2007: dividend yield 0%, expected volatility 66%, risk free interest rate 4.24% and expected remaining life of 3 years. The \$0.36 estimated weighted average fair value per option is amortized, on a straight-line basis over the vesting period of the options.

The fair value of each option granted to non-employees after 2002 is estimated as of the balance sheet date, using the Black-Scholes option-pricing model with the following weighted-average assumptions for the nine months ended September 30, 2007: dividend yield 0%, expected volatility 66%, risk free interest rate 4.60% and expected remaining life of 4.2 years. Options granted to non-employees are measured at each balance sheet date until vested. At September 30, 2007 the estimated weighted average fair value of options granted to non-employees during the nine months ended September 30, 2007 was \$0.50.

# ALLON THERAPEUTICS INC.

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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

The following options are outstanding under the Company's stock option plan:

Range of exercise prices	Options outstanding September 30, 2007		Weighted average exercise price	Options exercisable September 30, 2007	
	Number of common shares issuable	Weighted average remaining life		Number of common shares issuable	Weighted average exercise price
\$0.001-0.40	1,458,497	6.46	\$ 0.12	1,458,497	\$ 0.12
\$1.00-1.72	2,390,000	7.68	1.18	1,052,000	1.37
	3,848,497	7.54	\$ 0.77	2,510,497	\$ 0.64

## 6. Net loss per common share:

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

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Net loss for the period	\$ (3,242,315)	\$(1,975,807)	\$ (8,612,351)	\$(5,604,981)
Weighted average number of common shares outstanding	58,997,269	33,386,711	51,856,858	33,386,711
Net loss per common share	(0.05)	(0.06)	(0.17)	(0.17)

## 7. Related party transactions:

During the three and nine months ended September 30, 2007, Allon paid one of its Board members \$12,500 and \$37,500 respectively to provide consulting services to assist the Company with general research and the advancement of its drug development programs.

On October 31, 2006, Allon loaned \$143,155 to a Senior Officer of the Company. The loan was subject to an annual interest rate of 5.25%, consistent with market rates at the time the loan was granted. The loan was repaid, with interest, on February 2, 2007.

Allon receives annual installments of \$25,000 related to the 2004 sale of two investment management subsidiaries to a privately held company, owned by the Chairman and a Company director. At September 30, 2007, the amount receivable was \$50,000, discounted to a present

# **ALLON THERAPEUTICS INC.**

Notes to Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2007 and 2006

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value of \$47,756, all of which is included in accounts receivable. Subsequent to September 30, 2007, Allon received \$25,000. The balance of \$22,756, representing the final payment for this transaction, is due in September 2008.

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## **Corporate Office**

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