



YEAR ENDED DECEMBER 31, 2009

MANAGEMENT'S REPORT ON FINANCIAL POSITION AND OPERATING RESULTS

All amounts included in this report are expressed in Canadian dollars unless otherwise stated.

GENERAL

The following analysis provides a review of the Company's results of operations, financial condition and cash flows for the years ended December 31, 2009 and 2008. This analysis should be read in conjunction with the information contained in the consolidated financial statements and related notes for the years ended December 31, 2009 and 2008, appearing in the annual report of the Company, which are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

The 2009 Annual Report of the Company and additional information regarding the business of the Company are available on SEDAR at www.sedar.com.

COMPANY OVERVIEW

Medicago is committed to providing highly effective and affordable vaccines based on proprietary Virus-Like Particles (VLPs) and manufacturing technologies. Medicago is developing VLP vaccines to protect against H5N1 pandemic influenza, using a transient expression system which produces recombinant vaccine antigens in the cells of non-transgenic plants. This technology has potential to offer advantages of speed and cost over competitive technologies. It promises to deliver a vaccine for testing rapidly after the identification and reception of genetic sequences from a pandemic strain. This production time frame has the potential to allow vaccination of the population before the first wave of a pandemic strikes and to supply large volumes of vaccine antigens to the world market.

MARKET AND ECONOMIC SITUATION OVERVIEW

The influenza vaccine market is expected to expand over \$3.7 billion by 2010. We are developing products for a growing market, with a first product (H5N1 pandemic influenza VLP vaccine) expected to be on the market in 2012 or 2013, if all clinical phases are successfully completed and market approval is granted by the regulatory authorities.

We did not incur any losses on asset-backed commercial paper as we never invested in such securities. Our main credit facility (Biolevier) runs until 2014 and we have met all related requirements. In 2010, we have the financial resources required to work towards the attainment of our objectives (See *Products in development*) for the year, despite current economic conditions.

KEY DEVELOPMENTS FOR THE YEAR ENDED DECEMBER 31, 2009

CORPORATE

Partnership Agreement with GENOPOLE(R)

On July 21, 2009, Medicago and Genopole biopark (Evry, France), signed a partnership agreement with a plan to build a commercial facility to manufacture pandemic and seasonal influenza vaccines in France. Medicago and Genopole believe that this facility could complement France's existing domestic influenza vaccine production infrastructure by offering surge capacity of influenza vaccines before the first wave of a pandemic strikes. This agreement builds on the feasibility study announced in July, 2008, which was successfully completed this year to evaluate the economic and technological viability of a novel vaccine production facility in France.

Genopole and Medicago will work together to establish a commercial-scale facility based on Medicago's Proficia plant-based manufacturing technology and VLP vaccine technology on Genopole's site in Evry, France. The new facility would initially produce pandemic and seasonal influenza vaccines, and in the long term, could be used for a broad range of vaccines and other biodefense related products. With the successful completion of phase I clinical trial with its H5N1 pandemic influenza vaccine, construction of the facility is conditional upon a reasonable level of commitment by the French authorities to support this novel technology.

Memorandum of Understanding with Ajanta Pharma

Medicago has signed a memorandum of understanding with Ajanta Pharma Limited to discuss and negotiate an agreement to commercialize Medicago's pandemic and seasonal influenza VLP-based vaccines in India and other territories. Ajanta is one of India's fastest-growing pharmaceutical companies and has strong relationships with government health departments, defence services and hospitals. Under the terms of the memorandum of understanding, the parties will evaluate and select an optimal deal structure with the objective of formalizing a definitive agreement in the first half of 2010.

Letter of Intent with Tabuk Pharmaceuticals

On September 2, 2009, Medicago announced the execution of a letter of intent with Tabuk Pharmaceuticals to negotiate an agreement to develop, produce and commercialize Medicago's influenza VLP-based vaccines in Saudi Arabia and other territories in the Middle East and North Africa. Tabuk is the second-largest pharmaceutical manufacturer in Saudi Arabia. Under the terms of the letter of intent, the parties will collaborate to identify the interest of targeted governments and will select an optimal deal structure with the objective of establishing a commercial partnership within 12 months from the execution of the letter of intent.

Proof of Concept Contract with the U.S. Army

On October 8, 2009, the Company announced that it has been awarded a proof of concept contract by the United States Army Research, Development and Engineering Command laboratory specifically the Edgewood Chemical Biological Centre Research & Technology Directorate (ECBC). Medicago will work with ECBC to investigate the affordable production of industrial enzymes in the field of biofuels. This new project builds on Medicago's proprietary plant-based manufacturing platform and its potential for applications beyond the biological drug market.

While the Company remains focused on advancing its core influenza programs, biotechnology markets are quickly evolving and may offer new opportunities to the Company to increase shareholder value.

Public offering

On November 26, 2009 the company completed a public offering of 16,100,000 units (the 'Units') at a price of \$0.72 per Unit for gross proceeds of \$11,592,000. Each Unit consists of one common share in the share capital of Medicago (a 'Common Share') and one half common share purchase warrant (a 'Warrant'). Each Warrant entitles its holder to purchase one Common Share until November 26, 2010, at a price of \$1.00.

These funds will be used to further support the development of Medicago's pandemic and seasonal influenza vaccines programs.

PRODUCTS IN DEVELOPMENT

H5N1 PANDEMIC INFLUENZA VLP VACCINE

In the fourth quarter of 2009 the company reached an important milestone with the successful completion of its first human clinical trial with an H5N1 avian influenza vaccine. The vaccine was found to be safe, well tolerated and also induced a solid immune response.

The phase I study was designed to investigate the safety of the Company's H5N1 alum-adjuvanted pandemic vaccine candidate and to provide an initial indication of the immune response. A total of 48 healthy volunteers between the ages 18 to 60 received two doses of either Medicago's vaccine at doses of five, 10 or 20 micrograms or a placebo. No serious adverse events were reported during the trial and the vaccine was found to be well tolerated at all three dose levels. Local site reactions were mild and the incidence of systemic side effects was comparable between the H5N1 vaccine groups and the placebo. As planned in the initial design, adverse event monitoring will continue for six months after administration of the second vaccine dose. The trial was conducted at the vaccine evaluation centre of McGill University in Montreal, Canada, under the supervision of Dr. Brian Ward.

Preliminary results showed that 81 per cent of immunized subjects developed an immune response against the H5N1 virus after the second immunization. A four-fold increase in HI titers from baseline in 58 per cent of subjects was observed in the 20-milligram group. HI titers greater than 1:40 were developed in 50 per cent of the subjects in the 20 micrograms group. The H5N1 vaccine also induced the production of antibodies cross-reacting with two other strains of H5N1 avian influenza suggesting Medicago's vaccine potential for cross-protection. Full results of this trial will be submitted for publication in a scientific journal and will be available in the coming months.

In 2010, the Company will prepare a regulatory dossier which will be submitted to Health Canada in the following months. If granted approval, the company will initiate a phase 2 clinical trial in 2010 and results would be available in the fourth quarter of 2010.

SEASONAL AND H1N1 VACCINES

In the second quarter of 2009, Medicago successfully expressed a new VLP antigen (H1 VLP) from the influenza A (H1N1) strain that caused the recent influenza outbreak in North America and other countries. The antigen was expressed within 14 days of receiving the DNA sequence, with the Company's VLP vaccine and Proficia manufacturing technologies.

The Company has also received positive results from an immunogenicity study in mice with this new vaccine candidate for the influenza A (H1N1) virus, also known as swine flu. Results demonstrated that the Company's H1 VLP vaccine induced a positive immune response in 100 per cent of the mice against the H1N1 influenza A/California/04/09 virus.

In a continuation of this study, the Company has achieved additional positive results. Results showed that a single dose of five micrograms induced a positive immune response against a new emerging strain of this virus in 100 per cent of vaccinated animals. Medicago's H1N1 VLP vaccine was formulated to protect against the Influenza A/California/04/09 virus, which was one of the original viral strains selected by the World Health Organization for vaccine manufacturers. In this study, Medicago tested the immune response of its H1N1 vaccine against the California/07 virus and showed positive immune response after a single dose of five micrograms.

In 2010, the company will proceed with preclinical studies with its H1N1 pandemic vaccine candidate and expects to file a clinical trial application (CTA) in the fourth quarter of 2010 to initiate a phase 1/2 clinical trial. The strategy is to take advantage of the development work that will be completed for its H1N1 pandemic vaccine candidate to bolster its safety database and apply it to potentially shorten the path of approval for its seasonal vaccine candidate. Interim clinical data from the H1N1 trial, including measurements of safety and tolerability, are expected to be available by early 2011. With these data in hand and if granted approval by relevant regulatory authorities, Medicago could potentially commence a phase 2 clinical study with its seasonal candidate in 2011.

In 2009, the Company continued its research program initiated in 2008 and expects to commence preclinical work in 2010.

SELECTED ANNUAL CONSOLIDATED INFORMATION

	2009 \$	2008 \$	2007 \$
CONSOLIDATED STATEMENTS OF EARNINGS SUMMARY			
Revenues	-	2,248,000	74,000
Loss for the year			
\$	12,475,000	7,649,000	6,273,000
Basic and diluted loss per share	0.13	0.17	0.32

CONSOLIDATED BALANCE SHEET DATA			
Cash, cash equivalents and short-term investments	14,333,000	14,028,000	224,000
Total assets	22,830,000	20,603,000	6,662,000
Total long-term liabilities ⁽¹⁾	15,488,000	15,283,000	14,464,000

(1) Total long-term liabilities include long term-debt and current portion

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2009 AND 2008

Consolidated statements of earnings

For the year ended December 31, 2009, the company had no revenues compared to \$2,248,000 for the year ended December 31, 2008. Revenues in 2008 were generated by two agreements signed with Philip Morris International (PMI). The first agreement signed in 2007, a research service agreement of \$500,000 generated \$444,000 for the first nine-month of 2008 and revenues from the second one, a non-exclusive license agreement signed in February 2008, were \$2,000,000 for the first nine-month of 2008. Revenues from the non-exclusive license agreement were diminished by \$196,000 representing the value of the 2,000,000 common share purchase warrants granted to PMI at the signing of the agreement.

Research and development (R&D) expenses increased by \$3,218,000 to \$7,917,000 for 2009 compared to 2008. The increase in R&D expenses for the year ended December 31, 2009 compared to 2008 is related to the production of Phase I clinical materials and the beginning and completion of the phase I clinical study. Wage and salaries were higher (\$1,080,000) in 2009 compared to 2008 explained by hiring in the second-half of 2008 and since the beginning of 2009 of new employees required for the completion of the preclinical work and the production of clinical materials for the Phase I clinical study. More laboratory supplies and external analysis (\$868,000) and a higher level of outsourced contract work (\$1,041,000) were also required to perform these activities.

Research grants and contribution increased by \$269,000 to \$353,000 for the year ended December 31, 2009. The increase is mainly explained by the grant obtained in the second quarter of this year from Quebec's Consortium for Drug Discovery (CQDM) to develop the VLPEXpress, a high-throughput platform that will accelerate the Company's discovery and development of new vaccines by rapidly expressing, purifying and testing candidate VLPs, for \$137,000 and the grant obtained in 2008 from Canada's National Research Council (NRC) industrial research assistance program to support the development of the Company's seasonal influenza VLP vaccine program for \$160,000. The grant from the CQDM totaled \$1,773,000 of which \$1,636,000 is still available as of December 31, 2009 along with \$24,000 from the grant from the NRC.

Research and development tax credits were \$669,000 for the year ended December 31, 2009, \$252,000 lower than the year ended December 31, 2008. Although R&D expenses increased by 95 % in 2009 but following the completion of the private placement with PMI in 2008, the Company is now considered associated with PMI for tax purposes, resulting in a decrease of the tax credit rate at the provincial level from 37.5% to 17.5% and is no longer entitled to a Federal tax credit.

General and administrative, business development and intellectual property (G&A) expenses increased by \$731,000 to \$3,807,000 for the year ended December 31, 2009 compared to 2008. This is mainly explained by an increase in tradeshows and travelling expenses (\$120,000), license and patent related costs (\$85,000) and salaries and fringe benefits (\$346,000). The increase in salaries is explained by the hiring in 2009 of a director, investor relations and communications and a corporate controller, the fact that the CFO has been there for 12 months in 2009 compared to 8 months in 2008 and some remuneration adjustments. The variation in trade show and travelling for 2009 is explained by increased investor relations and business development activities.

Stock-based compensation increased by \$219,000 for the year ended December 31, 2009 following the grant of 3,472,650 stock options in the first quarter of 2009.

Depreciation of property, plant and equipment amounted to \$464,000 for the year ended December 31, 2009, comparable with the year ended December 31, 2008.

Amortization of intangible assets amounted to \$60,000 for the year ended December 31, 2009, \$39,000 lower than the year ended December 31, 2008. A write-off of a license of a carrying value of \$572,000 at the end of the third quarter of 2008 explained this decrease.

A write-off of intangible assets of \$572,000 occurred in 2008 and corresponds to the carrying value of a license acquired in 2001 in relation with molecular farming in alfalfa no longer used by the Company.

Net financial expenses amounted to \$924,000 for the year ended December 31, 2009, \$790,000 lower compared to the year ended December 31, 2008. This decrease is mainly the result of lower interest rate on the Bio-levier loan for \$343,000, higher interest income for \$184,000 explained by the increase in cash, cash equivalents and short-term investments and no expenses of warrants issued as financing fees in 2009 compared to \$258,000 in 2008.

Consolidated loss for the year ended December 31, 2009 was \$12,475,000, or \$0.13 per basic and diluted share compared to a loss of \$7,649,000, or \$0.17 per basic and diluted share for the year ended December 31, 2008.

Consolidated Balance sheet

Cash, cash equivalents and short-term investments were \$14.3 million as at December 31, 2009, an increase of \$0.3 million from \$14 million as at December 31, 2008.

Total consolidated assets were \$22.8 million as at December 31, 2009, an increase of \$2.2 million from \$20.6 million as at December 31, 2008. The variation is mainly due to an increase in property, plant and equipment for \$900,000 following the expansion of the pilot plant and Investment tax credits receivable for \$669,000.

Long-term debt increased by \$0.2 million to \$15.5 million, mainly the result of theoretical interests on non-bearing interest loans. .

QUARTERLY FINANCIAL DATA

	Quarters ended			
	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009
Revenues	-	-	-	-
Total expenses	(\$3,891,000)	(\$3,163,000)	(\$2,794,000)	(\$2,625,000)
Loss	(\$3,891,000)	(\$3,163,000)	(\$2,794,000)	(\$2,625,000)
Basic and diluted net loss per share	(\$0.04)	(\$0.03)	(\$0.03)	(\$0.04)
	December 31, 2008	September 30, 2008	June 30, 2008	March 31, 2008
Revenues	-	-	\$583,000	\$1,665,000
Total expenses	(\$3,007,000)	(\$2,739,000)	(\$2,160,000)	(\$1,991,000)
Loss	(\$3,007,000)	(\$2,739,000)	(\$1,577,000)	(\$326,000)
Basic and diluted net loss per share	(\$0.04)	(\$0.07)	(\$0.05)	(\$0.01)

Revenues from quarter to quarter may vary significantly. They are non-recurring by nature and are generated from licenses agreement as well as contract research agreement. It is also important to note that historical patterns of expenses cannot be taken as an indication of future expenses. The amount and timing of expenses and availability of capital resources vary substantially from quarter to quarter, depending on the level of R&D activity being undertaken at any one time and the availability of funding from investors and/or partners.

As described earlier, revenues for Q1 and Q2 of 2008 were generated by two agreements signed with PMI. The first agreement, a research service agreement of \$500,000, signed in 2007 and completed in 2008, generated \$444,000 in 2008 and revenues from the second one, a non-exclusive license agreement signed in February 2008 and completed in 2008, were \$2,000,000. Revenues from the non-exclusive license agreement were diminished by \$196,000 representing the value of the 2,000,000 common share purchase warrants granted to PMI at the signing of the agreement.

On a quarterly basis the R&D expenses increased in 2009 compared to 2008 and this is related to the production of Phase I clinical materials and the beginning and completion of the phase I clinical study. Wage and salaries increased in 2009 compared to 2008 explained by the hiring of new employees in the second half of 2008 and in 2009. More laboratory supplies and analysis and a higher level of outsourced contract work were also required to perform those activities.

FOURTH QUARTER RESULTS

The most important event for the Company in the fourth quarter of 2009 was the completion of a public offering of 16,100,000 units (the 'Units') at a price of \$0.72 per Unit for gross proceeds of \$11,592,000. These funds will be used to further support the development of Medicago's pandemic and seasonal influenza vaccines programs.

Each Unit consists of one common share in the share capital of Medicago (a 'Common Share') and one half common share purchase warrant (a 'Warrant'). Each Warrant entitles its holder to purchase one Common Share until November 26, 2010, at a price of \$1.00.

In addition, Medicago has granted the Underwriters a compensation option (the “Compensation Option”) to purchase 1,127,000 units (the “Compensation Option Units”) representing 7% of the total number of Units sold under this Offering.

For the fourth quarter ended December 31, 2009, the loss increased by \$884,000 to \$3,891,000 compared to \$3,007,000 for the fourth quarter of 2008. The increase is mainly explained by higher R&D expenses of \$1,284,000 partly compensated by the \$376,000 increase of investment tax credits.

The increase in R&D expenses of \$1,284,000 for the quarter ended December 31, 2009 compared to 2008 is related to the production of Phase I clinical materials and the completion of the phase I clinical study. Wage and salaries were higher (\$494,000) in 2009 compared to 2008 explained by hiring in the second-half of 2008 and since the beginning of 2009 of new employees required for the completion of the preclinical work and the production of clinical materials for the Phase I clinical study. More laboratory supplies and external analysis (\$229,000) and a higher level of outsourced contract work (\$447,000) were also required to perform these activities.

Research and development tax credits increases by \$376,000 for the quarter ended December 31, 2009. This increase is explained by an increase of 95 % in R&D expenses during the fourth quarter of 2009 and a provision of \$138,000 taken in the fourth quarter of 2008 for Federal tax credits.

LIQUIDITY, CASH FLOWS AND CAPITAL RESOURCES

The Company had cash, cash equivalents and short-term investments totaling \$14.3 million as at December 31, 2009, an increase of \$0.3 million from December 31, 2008. The Company had working capital of \$13.5 million as at December 31, 2009 compared to a working capital of \$13.6 million as at December 31, 2008. The Company does not have asset-backed commercial papers which are affected by liquidity issues. As at December 31, 2009, the Company's long-term debt amounted to \$15.5 million. Under the terms of the Bio-Levier loan agreement, the Company needs to maintain its current ratio at 1.3/1 or higher. As at December 31, 2009 this ratio stood at 5.07:1.

The Company's primary capital needs are the funds required to support its scientific research and development activities including preclinical and clinical trials, capital expenditures for the expansion of its pilot plant facilities and working capital. We expect our expenditures to increase in 2010 as we continue to advance our programs. We believe our existing capital resources are adequate to fund our plans for 2010.

Since its inception, the Company has financed its cash requirements primarily through issuances of securities, investment tax credits, government funding, cost recoveries, license agreement, contract research agreements, long-term debt and short-term debt guaranteed by its investment tax credits. The strategy of the Company for future funding is to find additional capital after a successful completion of the Phase II trial for its H5N1 pandemic influenza VLP vaccine. The amount of additional capital needed will depend on the cash on hand at that time and funds necessary to continue our clinical program. We anticipate funding additional capital requirements primarily through additional issuance of securities and/or the potential monetization of our products. (See section *RISK AND UNCERTAINTIES- Additional Financing Requirements and Access to Capital*)

The variation of our liquidity by activities is explained below.

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>Cash flows</i>	Year ended December 31, 2009	Year ended December 31, 2008
Operating activities	(\$10,841,000)	(\$5,710,000)
Financing activities	\$12,607,000	\$20,155,000
Investing activities ⁽¹⁾	(\$2,629,000)	(\$13,577,000)
Net change in cash	(\$863,000)	\$868,000

(1) Cash flows used in investing activities net of additions and disposition of short-term investments were (\$1,638,000) in 2009 and (\$592,000) in 2008.

Operating Activities

Cash used in operating activities increased by \$5,131,000 to \$10,841,000 for the year ended December 31, 2009 compared to 2008. This increase is explained by the increase in loss, net of items not affecting cash and cash equivalents (or burn rate) for \$6,355,000 and the change in non-cash working capital for \$1,223,000.

We expect net cash used in operating activities to increase in 2010, as we will begin and complete our Phase II clinical program with our H5N1 pandemic influenza vaccine and will further advance our seasonal influenza vaccine in preclinical program (see *Outlook for 2010*).

Financing Activities

For 2009, cash from financing activities decreased by \$7.6 million to \$12.6 million compared to 2008. In 2008, the Company completed three private placements, for total gross proceeds of \$20,785,000 when in 2009 the Company completed one public offering issuing 16,100,000 at \$0.72 per unit for gross proceeds of \$11,592,000 for a decrease of \$9,193,000 in issuance of units. This decrease was partly offset by the exercise of 8,346,750 warrants totalling \$2,363,000.

Investing Activities

Cash used in investing activities (excluding additions and disposition of short-term investments) increased by \$996,000 to \$1,588,000 in 2009 mainly explained by more additions of property, plant and equipment for \$897,000. In 2009, the Company expanded its manufacturing facility to optimize manufacturing activities and provide additional space to produce clinical-grade material for human clinical trials within its \$1.25 million budget.

The Company plans to invest \$1.9 million in 2010 to expand its manufacturing activities and provide additional space to produce clinical-grade material for phase II human clinical trials.

CONTRACTUAL OBLIGATIONS

The Company has certain contractual obligations and commercial commitments. The following table indicates the Company's cash requirements to comply with these obligations:

Minimum payments under the Company's contractual obligations are as follows as at December 31, 2009:

\$	2010	2011	2012	2013	2014	Thereafter	Total
Accounts payable	2,301,518	-	-	-	-	-	2,301,518
Bank loans	600,000	-	-	-	-	-	600,000
Long-term debt	83,862	66,629	60,000	60,000	15,318,640	834,635	16,423,766
Operating leases	213,749	264,510	263,043	144,111	39,672	-	925,085
Licenses	152,000	152,000	152,000	152,000	152,000	150,000	910,000

OUTLOOK FOR 2010

We expect R&D expenses to increase in 2010. Following the recent successful completion of a phase 1 clinical trial with its H5N1 pandemic vaccine candidate, Medicago is now preparing a regulatory dossier which will be submitted to Health Canada in the following months. If granted approval, the company will initiate a phase 2 clinical trial in 2010 and results would be available in the fourth quarter of 2010.

The company is also proceeding with preclinical studies with its H1N1 pandemic vaccine candidate and expects to file a clinical trial application (CTA) in the fourth quarter of 2010 to initiate a phase 1/2 clinical trial. Medicago's strategy is to take advantage of the development work that will be completed for its H1N1 pandemic vaccine candidate to bolster its safety database and apply it to potentially shorten the path of approval for its seasonal vaccine candidate. Interim clinical data from the H1N1 trial, including measurements of safety and tolerability, are expected to be available by early 2011. With these data in hand and if granted approval by Health Canada, the U.S. Food and Drug Administration, and Europe, the Middle East and Africa (EMEA), Medicago could potentially commence a phase 2 clinical study with its seasonal candidate in 2011.

Our expectations are that the cash outflow will not proceed linearly through the year but will be higher in the second half of the year due to cost associated with clinical studies and the cost of the expansion of our manufacturing facility.

RELATED PARTY TRANSACTIONS AND OFF-BALANCE SHEET AGREEMENTS

There were no related party transactions and off-balance sheet agreements.

OUTSTANDING SHARE DATA

As at March 23, 2010, there were 118,215,190 common shares issued and outstanding, 7,040,612 stock options outstanding, 57,120,696 warrants outstanding, and 1,127,000 unit options outstanding.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities reported in the financial statements. Those estimates and assumptions also affect the disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the year. Significant estimates are generally made in connection with the calculation of revenues, research and development expenses, stock-based compensation expense, as well as in determining future income tax assets and liabilities, the useful lives of property, plant and equipment and intangible assets with finite lives and the valuation of intangible assets, the fair value of stock options granted, and certain accrued liabilities. Estimates are based on historical experience, where relevant, and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

The following summarizes our critical accounting policies and other policies that require the most significant judgment and estimates in the preparation of our consolidated financial statements.

Impairment of long-lived assets

Long-lived assets are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the asset is greater than the pre-tax undiscounted future cash flows expected to be provided by the asset. The amount of impairment loss, if any, is the excess of the carrying value of the asset over its fair value.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between the carrying amounts and tax bases of the assets and liabilities. Changes in the future income tax assets or liabilities are included in the statements of earnings. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to be in effect for the year in which the differences are expected to reverse.

The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

Research and development costs

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research activities are expensed as incurred. Development expenses which meet generally accepted criteria for deferral are capitalized and amortized against earnings over the estimated period of benefit. As at December 31, 2009 and 2008, no development costs have been deferred.

Revenue recognition

Revenues related to research agreements are bound to milestone agreements and are recorded as the milestones are reached and upon customer acceptance. Under these agreements, the payments received in advance are recognized as deferred revenue in the

balance sheet and then, as revenue when milestone are reached and upon customer acceptance. Revenue from research agreements are recognized using the percentage-of-completion method.

The existing licensing agreement usually foresees one-time payment (upfront payment) and milestone payments. Revenues associated with those multiple-element arrangements are allocated to the various elements based on their relative fair value. Agreements containing multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered obligation(s). The consideration received is allocated among the separate units based on each unit's fair value or using the residual method, and the applicable revenue recognition criteria are applied to each of the separate units.

License fees representing non-refundable payments received upon the execution of license agreements are recognized as revenue upon execution of the license agreements when the Company has no significant future performance obligations and collectability of the fees is assured. Upfront payments received at the beginning of licensing agreements are not recorded as revenue when received but are amortized based on the progress to the related research and development work. This progress is based on estimates of total expected time or duration to complete the work which is compared to the period of time incurred to date in order to arrive at an estimate of the percentage of revenue earned to date.

Stock-based compensation and other stock-based payments

The company has a stock option plan which is described in note 13 of the financial statements As regards stock options granted to non-employees, the company uses the fair value-based method of accounting. The fair value of stock options is determined using the Black-Scholes option pricing model and stock-based compensation costs are recognized over the vesting period of the options and are recorded in Shareholders' Equity under caption "Other equity components". Any consideration received by the company on the exercise of stock options and the carrying value of those stock options are recorded in Shareholders' Equity under caption "Share capital" upon the issuance of shares.

NEW ACCOUNTING STANDARDS AND FUTURE ACCOUNTING CHANGES

Adopted in 2009

On January 1, 2009, the Company adopted Section 3064, "Goodwill and Intangible Assets", of the Canadian Institute of Chartered Accountants ("CICA") Handbook. This section establishes standards for the recognition, measurement and disclosure applicable to intangible assets. It replaces Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". The adoption of this new standard had no significant impact on the financial position and results of operations of the company.

In January 2009, the CICA's Emerging Issue Committee ("EIC") issued Abstract EIC-173, " Credit Risk and the Fair Value of Financial Assets and Liabilities" , which requires entities to take both counterparty credit risk and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives. EIC-173 will be effective for interim and annual periods beginning on or after January 1, 2009. The adoption of this guidance had no significant impact on the consolidated financial statements.

In June 2009, the Canadian Accounting Standards Board issued amendments to Section 3862, "Financial Instruments – Disclosures", to improve disclosure requirements on fair value measurement and liquidity risk.

The amendments are effective for the Company's December 31, 2009 annual financial statements. As the amendments only concern disclosure requirements, they will not have a significant impact on results or financial position.

Future accounting changes

In January 2009, the CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

(a) Section 1582, "Business Combinations", which replaces the former Section 1581 with the same title, establishes accounting standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS3, "Business Combinations".

(b) Section 1601, "Consolidated Financial Statements", which replaces the former Section 1600 with the same title, establishes standards for the preparation of consolidated financial statements.

(c) Section 1602, "Non-Controlling Interests". This new section establishes standards on accounting for non-controlling interests in a subsidiary in consolidated financial statements prepared subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements".

The Company is currently evaluating the impact of these new standards on its financial statements.

International Financial Reporting Standards

In February 2008, the Accounting Standards Board ("AcSB") confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011, with early adoption allowed starting in calendar year 2009. The conversion to IFRS will be required for the Company, for interim and annual financial statements beginning on January 1, 2011 and will require the restatement for comparative figures. The Company has decided to switch to IFRS on January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement, presentation and disclosures.

During 2008, we proceeded to establish a stage 1: *Diagnosis for the adoption of IFRS*. This diagnosis has identified the main differences between the accounting treatments applied by the Company under Canadian GAAP and the IFRS as well as the practical implications related to the measure. The differences were further classified according to their degree of complexity and by the amount of work to implement with respect to the measure.

An implementation plan for the conversion to IFRS has been prepared. The activities planned in stage 2: *Evaluation and Design* include the identification and documentation of existing differences between IFRS and Canadian GAAP in accounting and disclosure requirements, the selection of accounting policies under IFRS, including the consideration of options available under IFRS, the establishment of the effects related to the conversion on internal controls, accounting systems and other solutions and business processes, and developing a training program to help employees concerned for the transition and the continued compliance with IFRS. Finally, the stage 3, the last stage, is the implementation and the review.

During 2009, we practically completed stage 2 of our conversion to IFRS. The Company evaluated and documented the existing differences between IFRS and Canadian GAAP in accounting and disclosure requirements, the selection of accounting policies under IFRS, including the consideration of options available under IFRS, the integration of the effects related to the conversion on internal controls, accounting systems and other solutions and business processes, and the establishment of training program to help employees concerned for the transition and the continued compliance with IFRS.

While working on stage 2, under IFRS 1 - *First-time adoption of IFRS*, we have chosen to use the prospective application where choices were available for our situation. So far we found no Standard with significant accounting impact for the Company.

During 2010, we will finalize the stage 2 and work on stage 3 for the implementation and review. Since stage 2 is not completed as of December 31, 2009, other accounting impact can be found during the course of 2010. The global implementation plan is on schedule and we are confident that everything will be in place for the conversion planned on January 1, 2011.

CAPITAL MANAGEMENT

The Company views capital as the sum of Long-term debt and Shareholders' Equity.

The Company's objectives when managing capital is to safeguard the Company's ability to continue as a going concern in order to provide an adequate return to shareholders and maintain a sufficient level of funds to finance its research and development activities, general and administrative expenses, working capital and overall capital expenditures, including those associated with patents and trademarks.

To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets all subject to market conditions and the terms of the underlying third party agreements.

The Company is not subject to any capital requirements imposed by a regulator and was not in default under any of its obligations regarding its long-term debt as of December 31, 2009.

FINANCIAL INSTRUMENTS RISK FACTORS

Financial risk

The Company is exposed to various types of risks owing the nature of the business activities it carries on, including those related to the use of financial instruments. The Company does not use financial derivatives.

Market risk

Market risk corresponds to the financial losses that the Company could incur because of unfavourable fluctuations in the value of financial instruments, following variations in the parameters underlying their evaluation, such as interest rates and exchange rates. The exposure to variation to interest rates is described hereunder.

Foreign Currency Risk

Regarding the exposure to foreign exchange rates, the Company operates internationally and a portion of our expenses are incurred in US dollars and Euros but these exposures are not material.

Interest rate risk

As at December 31, 2009, the company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Variable interest rate
Short term investments	Fixed interest rate
Accounts receivable	Non-interest bearing
Grants receivable	Non-interest bearing
Bank loans	Variable interest rate
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 11

Bank loans (note 8) bear interest at variable rate and as at December 31, 2009, everything else being equal a 1% increase in interest rate on the bank loans would have had an unfavourable impact of \$6,000 on loss and comprehensive loss. A 1% decrease in interest rate would have had the opposite impact on loss and comprehensive loss.

The Biolevier loan (note 11) bears interest at variable rate and as at December 31, 2009, everything else being equal a 1% increase in interest rate on the debt would have had an unfavourable impact of \$153,186 on loss and comprehensive loss. A 1% decrease in interest rate would have had the opposite impact on loss and comprehensive loss.

Credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Cash and cash equivalents are maintained with high-credit quality financial institutions. Short-term investments consist primarily of term deposits, bonds and residuals issued by high-credit quality institutions. Consequently, management considers the risk of non-performance related to cash and cash equivalents and short-term investments to be minimal.

Liquidity risk

Liquidity risk represents the possibility that the Company may not be able to gather sufficient cash resources, when required and under reasonable conditions, to meet its financial obligations. The Company believes that, with the financial resources currently at its disposal, it has sufficient cash and cash equivalents to meet its contractual liabilities until the first quarter of 2011. To meet all its contractual liabilities, the Company will need to raise additional funds in the future and will seek additional forms of debt or equity financing, but cannot provide assurance that we will be successful in doing so. See 'Risk Factors' hereunder.

RISK FACTORS AND UNCERTAINTIES

Additional Financing Requirements and Access to Capital

The Company requires significant additional funds for further research and development, planned clinical trials, regulatory approvals, establishment of pilot scale and commercial manufacturing capabilities and the marketing of its products and product candidates. Medicago has no committed sources of capital. An attempt may be made to raise additional funds for the aforementioned purposes through public or private equity or debt financing, and collaborations with other companies, or financing from other sources may be undertaken. There can be no assurance that additional funding will be available at reasonable terms or at all. Any future equity financing may be dilutive to existing shareholders. If Medicago cannot obtain adequate funding on reasonable terms, it may need to: terminate or delay clinical trials for its product candidates; delay its establishment of sales or marketing capabilities; curtail significant product development programs that are designed to identify new product candidates; and sell or assign rights to its technologies, products or product candidates. The Company's ability to sell or monetize its technologies or products or the terms at which it could do so could be limited by the terms of existing agreements, including the right of first refusal of PMP on the Company's technology platform.

Recent market events and conditions

In 2007, 2008 and into 2009, the U.S. credit markets began to experience serious disruption due to a deterioration in residential property values, defaults and delinquencies in the residential mortgage market (particularly, sub-prime and non-prime mortgages) and a decline in the credit quality of mortgage backed securities. These problems led to a slow-down in residential housing market transactions, declining housing prices, delinquencies in non-mortgage consumer credit and a general decline in consumer confidence. These conditions continued and worsened in 2008 and early 2009, causing a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by the U.S. and foreign governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. In addition, general economic indicators have deteriorated, including declining consumer sentiment, increased unemployment and declining economic growth and uncertainty about corporate earnings.

These unprecedented disruptions in the current credit and financial markets have had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. These disruptions could, among other things, make it more difficult for the Company to obtain, or increase its cost of obtaining, capital and financing for its operations. The Company's access to additional capital may not be available on terms acceptable to it or at all.

Stage of Development

Medicago is still in development and still has a short operating history. The Company's product candidates or third-party products will require additional development and investments to move through commercialization and it is not certain that these products will be produced at reasonable cost and quality or be successfully marketed. It is not known whether the Company's investment in such products or product candidates will be recovered through sales or royalties.

Since the Company's more advanced products are in clinical development, the Company still has not fully demonstrated efficacy in humans for any of the Company's produced proteins or received any regulatory market approval. It is not known whether the Company will meet applicable health regulatory standards and obtain the required regulatory approvals for its actual products or product candidates.

Currently, the Company's ability to produce a commercial quantity of its products and product candidates has not been tested and the Company still does not have the manufacturing capacity to produce at such a commercial level. Additional investments will be required to build the manufacturing capacity to meet the market needs and these scale-up operations may change the Company's cost structure that may affect some of its platform benefits or lower capital costs and lower the cost of goods sold.

The Company is still several years away from commercialization and it may encounter unforeseen difficulties or delays in its operations and it is possible that competitors may develop alternative production methods which could reduce the Company's competitive advantages.

Medicago is highly dependant on the success of its lead product, its H5N1 vaccine candidate

Medicago depends heavily on the success of its lead product, its H5N1 vaccine candidate. Medicago has invested a significant portion of its financial resources in the development of this lead product and anticipates that in the near term, its ability to generate significant revenues will depend primarily on the successful development and commercialization of this product. Although Medicago has other technologies and products under development, they are at an earlier stage of development.

History of Operating Losses

As at the present date, the Company has not recorded any revenues from the sale of products or product candidates. The Company has an accumulated deficit, since its inception through December 31, 2009 of \$56,395,186. Losses could increase in the near term as the Company continues its product development and, in the case of pharmaceutical proteins, seeks regulatory approval for the sale of its product candidates. Operating losses are expected to be incurred until such time as product sales and royalty payments are sufficient to generate revenues to fund its continuing operations. Quarter-to-quarter fluctuations in revenues, expenses and losses are also expected. Medicago may never achieve profitability. Even if it achieves profitability, it may not be able to maintain profitability on an annual or quarterly basis. Medicago's failure to become and remain profitable would depress the market price of its common shares and could impair its ability to raise capital, expand its business, expand its product pipeline or continue its operations.

Regulation of Drug and Product Approval

Potential purchasers should be aware of the risks, problems, delays, expenses and difficulties which the Company may encounter in light of the extensive regulatory environment in which its business is carried on. Numerous statutes and regulations govern the manufacture and sale of human therapeutic products in Canada, the United States and other countries, the intended markets for the Company's products and product candidates. Such legislation and regulation bears upon the approval of manufacturing facilities, testing procedures and controlled research, preclinical and clinical data prior to marketing approval, including adherence to cGMP standards during production and storage, as well as regulation of marketing activities, including advertising and labelling. For example, the conditions of Health Canada on the manufacture of the Company's H5N1 vaccine candidate include compliance with cGMP standards. While the Company believes it is compliant with such cGMP standards, this will have to be ascertained to Health Canada's satisfaction as part of the regulatory approval process. To the extent additional work is required in this connection, the estimated timing and costs for the development of its products may be adversely impacted.

Many of the products, product candidates and processes that the Company is currently developing require significant development, testing and the investment of significant funds prior to their commercialization. There can be no assurance that any of such products, product candidates or processes will actually be developed to a commercial level.

Before obtaining regulatory clearance for the commercial sale of any of the Company's pharmaceutical product candidates, the Company must demonstrate through preclinical studies and clinical trials that the potential product candidate is safe and efficacious for use in humans for each target indication. The results from preclinical studies and early clinical trials may not be predictive of results that will be obtained in large-scale testing, and there can be no assurance that the Company's clinical trials will demonstrate sufficient safety for an Investigational New Drug Application (the documentation submitted to the Food and Drug Administration (the "FDA") to obtain approval to test drug on patients) or subsequent phases or steps in human trials even after preclinical testing and/or human data is submitted. The failure to adequately demonstrate the safety and efficacy of a product candidate under development could delay or prevent regulatory clearance of the potential product candidate and would have a material adverse effect on the Company's success.

Any drug is likely to produce some toxicity or undesirable side effects in animals and in humans when administered as a monotherapy or in combination with other drugs. There can be no assurance that unacceptable toxicity, adverse events or side effects will not occur at any dose level at any time in the course of toxicological studies or of human clinical trials of the Company's potential product candidates as a monotherapy or in combination with other drugs. The appearance of any such unacceptable toxicity, adverse events or side effects in toxicology studies or in clinical trials could cause the Company or regulatory authorities to interrupt, limit, delay or abort the development of any of the Company's product candidates and could ultimately prevent their clearance by Health Canada, the FDA or other regulatory authorities, for any or all targeted indications. There can be no assurance that a phase, component or step of a trial will be successful or safely completed allowing a subsequent phase, step or component of a trial or a trial's design to commence. There is no assurance that Health Canada, the FDA or other regulatory authorities will accept a specific protocol or protocol design regardless of phase, steps or components of a phase. Furthermore, after a trial or phase of a trial has commenced, Health Canada, the FDA or other regulatory authorities could place the trial on clinical hold if Health Canada, the FDA or other regulatory authorities determine a trial or its design may be unsafe or require clarifications regarding protocol design. If the Company is placed on clinical hold, there is no assurance the objections or issues will be overcome or resolved and such trial could be postponed and/or terminated. Even after being cleared by Health Canada, FDA or other regulatory authorities, a product candidate may later be shown to be unsafe or not to have its purported effect, thereby preventing its widespread use or requiring withdrawal from the market. There can be no assurance that any product candidates the Company has developed or will develop will be safe when administered to patients.

The rate of completion of clinical trials in relation to the Company's products will be dependent upon, among other factors, the rate of patient enrolment. Patient enrolment is a function of many factors, including the size of the patient population, the nature of the protocol, competing trials for the same patient population, the proximity of parties to clinical sites, the eligibility criteria for the study and interest of clinical investigators. Delays in planned patient enrolment may result in increased costs, delays or termination of clinical trials, which could have a material adverse effect on the Company's success. In addition, the Company's staff has limited clinical experience and, as a result, will rely on third parties to assist the Company in overseeing and monitoring the clinical trials, which may result in delays in completing clinical trials, or them not being completed at all, if such third parties fail to perform under their agreements with the Company or fail to meet regulatory standards in the performance of their obligations under such agreements. There can be no assurance that the Company will be able to submit a new drug application as scheduled if clinical trials are completed or that any such applications will be reviewed and cleared by Health Canada or FDA in a timely manner or at all.

Also, the statutes, regulations, or policies of Canada, the United States or other countries may change and additional statutes or government regulations or policies may be enacted which could prevent, or impose additional restrictions on the continued marketing of drug products.

Limits and challenges after a regulatory approval

Even if regulatory approval of a product is granted, the approval may be subject to limitations on the uses for which the product may be marketed or to conditions of approval, which could affect the marketability of the product. Moreover, additional work on a product after regulatory approval at a certain development stage may be required to access the next development stage. This additional work could require significant costs and delay the advancement of the product.

In addition, the terms of approval may contain requirements for costly post-market follow-up studies or post-market surveillance to monitor the safety or efficacy of the product, which could reduce revenues, increase expenses or render the approved product not commercially viable. For example, Health Canada or the FDA could require implementation of a risk management program in order to monitor the potential abuse, misuse, diversion, or other risks associated with the utilization of a product. Also, regulatory submission is required to contain adequate data to assess the safety and efficacy of the drug for the claimed indication in all relevant pediatric subpopulations. Regulatory authorities may grant waivers and deferrals requests of this requirement or require various post-approval commitments.

If Medicago eventually receives regulatory approval to market a particular product, it will be subject to extensive ongoing regulatory requirements, including requirements relating to registration, manufacturing, labeling, advertising, promotion, adverse event reporting, packaging, distribution, storage, and record keeping. In addition, the manufacturing facilities for such product will be subject to continual review and periodic inspections by regulatory authorities. If Medicago fails to comply with the regulatory requirements of Health Canada, the FDA and other applicable domestic and foreign regulatory authorities, or if previously unknown problems with any approved commercial products, manufacturers or manufacturing processes are discovered, it could be subject to administrative or judicially imposed sanctions or other setbacks.

Potential inability to achieve projected development goals in the time frames announced and expected

Medicago sets goals for and make public statements regarding its expected timing of meeting the objectives material to its success, such as the commencement and completion of clinical trials, anticipated regulatory approval and product launch dates. The actual timing of these forward looking events can vary dramatically due to factors such as delays or failures in its clinical trials, the need to develop additional data required by regulators as a condition of approval, the uncertainties inherent in the regulatory approval process, delays in achieving manufacturing or marketing arrangements necessary to commercialize its product candidates and failure by its collaborators, marketing and distribution partners, suppliers and other third parties with whom Medicago has contractual arrangements, to fulfill, in whole or in part, their contractual obligations towards it.

Regulation of Genetically Engineered Plants

The Company must comply with regulations of the United States Department of Agriculture (the “USDA”), the Canadian Food Inspection Agency (the “CFIA”) and other regulatory authorities for outdoor releases of genetically engineered organisms as well as other products designed for use on or with agricultural products. The USDA and the CFIA prohibit growing and transporting genetically modified plants except pursuant to an exemption or under special permits. In order to obtain the required permits, the Company will be required to demonstrate that the Company has satisfactory procedures for the growth of its genetically modified plants and for the control of seed stocks, harvested material, processing facilities, and waste material from such plants. There can be no assurance that permits will be granted to the Company in a timely fashion, if at all. In addition, the conditions to the grant of such permits may be time consuming or expensive for the Company to fulfill. Furthermore, changes in regulations or policies of the USDA, the CFIA and other regulatory authorities regarding the growth and movement or field release of genetically modified plant hosts could adversely affect the Company’s business by increasing the cost of its products and technologies or decreasing consumer demand for those products and technologies or causing governments to prohibit their sale or use. If the Company fails to comply with such rules or policies, it may be subject to financial loss or be liable for costs incurred as a result of non-compliance. To the knowledge of the Company, no regulatory requirement for the outdoor commercial growth of transgenic plants producing pharmaceutical proteins has been promulgated in Canada, the United States or elsewhere.

Rapid Technological Change

Considering the rapid evolution and the substantial technological change of the industry, there can be no assurance that developments by others will not render the Company’s technologies non-competitive or that the Company will be able to keep pace with technological developments. The Company’s competitors may also have developed or may be developing technologies which could become the basis for competitive products and product candidates. Some of these products and product candidates may prove to be more effective and less costly than the products and product candidates developed or that are being developed by the Company.

Dependence on Key Personnel

The Company depends on certain members of its management and scientific staff and the loss of services of one or more of said persons could adversely affect the Company. It is necessary for the Company to continue to implement and improve its management systems and to continue to recruit and train new employees in order to manage its growth effectively. In particular, the Company will need to recruit personnel with experience in cGMP manufacturing, drug development and quality control. While the Company has been able to attract and retain skilled and experienced personnel in the past, no assurance can be given that it will be able to do so in the future.

Competition

Technological competition is intense in the industry in which the Company operates. Competition comes from pharmaceutical companies, biotechnology companies and universities as well as companies that participate in each of the non-pharmaceuticals markets the Company is attempting to address with its products and product candidates. Many of the Company’s competitors have substantially more financial and technical resources, more extensive research and development capabilities and greater marketing, distribution, production and human resources than the Company. Moreover, competitors may develop products before the Company develops its own products and product candidates and may obtain regulatory approval for such products and product candidates more rapidly than the Company. Products and product candidates and processes which are more effective than those that the Company intends to develop may be developed by the Company’s competitors. Research and development by others may render the Company’s technology, products and product candidates or processes non-competitive or obsolete.

Negative Public Reaction to Genetically Engineered Technology

Future commercial success of some of the Company's products and product candidates and of the products of some of its partners will depend in part on public acceptance of the use of genetically engineered products and product candidates, including drugs, plants and plant products. Claims that genetically engineered products and product candidates are unsafe for consumption or pose a danger to the environment may influence public attitudes, regardless of their veracity. Negative public reaction to genetically modified organisms and products and product candidates could result in greater government regulation of genetic research and resultant products and product candidates, including stricter labelling requirements, and could cause a decrease in the demand for the Company's products and product candidates, even if such products and product candidates do not result from genetically modified organisms.

Patents and Proprietary Rights

The Company's success depends, in part, on its ability to secure and protect its intellectual property rights and to operate without infringing on the proprietary rights of others or having third parties circumvent the rights owned or licensed by the Company. Applications for patents in Canada, the United States and in other jurisdictions have been filed and the Company is actively pursuing them. The patent positions of pharmaceutical and biotechnology firms, including the Company, are uncertain and involve complex questions of law and fact for which important legal issues remain unresolved. Therefore, it is not clear whether the Company's pending patent applications will result in the issuance of patents or whether the Company will develop additional proprietary products and product candidates which are patentable. Part of the Company's strategy resides on its ability to secure a patent position around the production of a recombinant protein using its Proficia™ technology platform. There is no assurance that the Company will be successful in this approach and failure to secure patent protection may have a material adverse effect upon the Company and its financial condition. Also, the Company may fail in its attempt to commercialize products and product candidates without having to license additional patents, such as patents relating to plant transformation or the use of certain plant specific genetic elements. Moreover, it is not clear whether the patents issued or to be issued to the Company will provide it with any competitive advantages or if any such patents will be the target of challenges by third parties, whether the patents of others will interfere with its ability to market its products and product candidates or whether third parties will circumvent its patents by means of alternate processes. Furthermore, it is possible for others to develop products and product candidates which have the same effect as the Company's products and product candidates or production technologies on an independent basis or to design around technologies patented by the Company.

Patent applications relating to or affecting the Company's business have been filed by a number of pharmaceutical and biotechnology companies and academic institutions. A number of these technologies, applications or patents may conflict with the Company's technologies or patent applications and such conflict could reduce the scope of patent protection which the Company could otherwise obtain or even lead to refusal of its patent applications.

If third parties engage in activities that infringe the Company's proprietary rights, management's focus will be diverted and the Company may incur significant costs in asserting its rights. The Company may not be successful in asserting its proprietary rights, which could result in its patents being held invalid or a court holding that the third party is not infringing the Company's proprietary rights, either or which would harm the Company's competitive position. In addition, there is no assurance that others will not design around the Company's patented technology. Moreover, the Company may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office, European opposition proceedings, or other analogous proceedings in other parts of the world to determine priority of invention and the validity of patent rights granted or applied for, which could result in substantial cost and delay, even if the eventual outcome is favourable to the Company.

There is no assurance that the Company will be able to enter into licensing arrangements on reasonable commercial terms, or develop or obtain alternative technology in respect of patents issued to third parties that incidentally cover its products or production technologies. Any inability to secure licenses or alternative technology could result in delays in the introduction of some of the Company's products or product candidates or even lead to prohibition of the development, manufacture or sale of certain products by the Company. Moreover, the Company could potentially incur substantial legal costs in defending legal actions which allege patent infringement, or by instituting patent infringement suits against others.

It is not possible for the Company to be certain that it is the creator of inventions covered by pending patent applications or that the Company was the first to file patent applications for any such inventions. No assurance can be given that the Company's patents, once issued, would be upheld by a court, or that a competitor's technology or product would be found to infringe on the Company's patents.

In addition, the Company's technology, products and products candidate may include intellectual property of third parties used under license, such as is currently the case with the Company's H5N1 vaccine candidate. The same risks and uncertainties described herein apply to such third parties' intellectual property, and could adversely affect the Company's ability to develop, manufacture or sell products or value its technologies.

Moreover, much of the Company's know-how technology which is not patentable may constitute trade secrets. Therefore, the Company requires its employees, consultants, advisors and collaborators to enter into confidentiality agreements. However, no assurance can be given that such agreements will provide for a meaningful protection of the Company's trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure of information.

Potential Product Liability

A risk of product liability claims and related negative publicity is inherent in the development of human therapeutic and other products. Product liability insurance is expensive, its availability is limited, and may not be on terms acceptable to the Company, if at all. The commercialization of the Company's potential products and product candidates could be inhibited or prevented by an inability to maintain sufficient insurance coverage on reasonable terms or to otherwise protect against potential product liability claims. A product liability claim against the Company or the withdrawal of a product or product candidates from the market could have a material adverse effect upon the Company and its financial condition.

Unproven Market

Much of the Company's strategy is based on the belief that the application of its technologies to develop products and product candidates for the markets it is addressing will result in the creation of new, commercially viable products. Notwithstanding the Company's estimated market potential for its products and product candidates, no assurance can be given that these beliefs will prove to be correct owing to, in particular, competition from existing or new products and the yet to be established commercial viability of its products and product candidates.

Market Acceptance

Even if the Company develops safe and effective products and obtains the necessary regulatory approvals, the process will take years, and by the time this occurs, because of the competitive and dynamic nature of the drug development industry, there is a risk that at such time, any such product:

- will not be economical to market, reimbursable by third party payers, or marketable at prices that will allow the Company to achieve profitability;
- will not be successfully marketed or achieve market acceptance;
- will not be preferable to existing or newly developed products marketed by third parties; or,
- will infringe proprietary rights held by third parties now or in the future that would preclude Medicago from marketing any such product.

The degree of market acceptance of products developed by Medicago, if any, will depend on a number of factors, including the establishment and demonstration in the medical community of the clinical efficacy and safety of the Company's products and their potential advantage over alternative treatment methods. There is no assurance that physicians, patients or the medical community in general will accept and utilize any products that may be developed by the Company.

In addition, by the time the Company's products, if any, are ready to be commercialized, what the Company believes to be the market for these products may have changed. Any estimates referenced herein of the number of patients who have received or might have been candidates to use a specific product may not accurately reflect the true market or market prices for such products or the extent to which such products, if successfully developed, will actually be used by patients.

The Company's failure to successfully introduce and market its products that are under development would have a material adverse effect on its business, financial condition and results of operations.

Sales, Marketing and Distribution Capabilities

The Company currently has no sales, marketing or distribution capability. The Company intends to rely primarily on its partners to market its product candidates, if and when approved; however, there can be no assurance that such partners or collaborators have effective marketing, sales and distribution capabilities.

If the Company or its partners are unable to establish or maintain relationships with partners with sales, marketing or distribution capabilities and the Company or its partners are required to market any of the Company's products directly, the Company or its partners will have to develop a marketing and sales force with technical expertise and with supporting distribution capabilities. There can be no assurance that the Company or its partners will be able to establish or maintain such relationships with third parties or develop in-house marketing, sales and distribution capabilities.

Commercial Manufacturing

The Company has no experience manufacturing commercial quantities of products and does not currently have the resources to commercially manufacture any products that the Company may develop. Accordingly, if the Company becomes successful in developing any product with commercial potential, the Company would either be required to develop the facilities to manufacture independently or secure a contract manufacturer or enter into another arrangement with third parties to manufacture such products. If the Company is unable to develop such capabilities or enter into any such arrangement on favourable terms, the Company may be unable to compete effectively in the marketplace. If the Company is unable to manufacture or contract for a sufficient supply of product on acceptable terms, or if the Company encounters delays or difficulties in its relationships with manufacturers or collaborators, its preclinical, clinical testing and/or product sales could be delayed, thereby delaying the submission of products for regulatory approval and/or market introduction and subsequent sales of such products.

Dependence on Collaborative Partners

The Company's strategy is to enter into various arrangements for clinical testing, and eventual manufacturing, marketing and commercialization of its products and product candidates. The Company also expects to enter into collaborations for the potential development and commercialization of its products and product candidates with other firms, pursuant to which the Company may receive additional funding, including milestone payments. The Company also intends to enter into additional corporate partnership agreements to develop and commercialize products and product candidates based upon its core technology. However, the conclusion of any such agreements may be delayed or limited by the terms of other existing agreements to which the Company is a party, including the right of first refusal under the existing agreements with PMP on the Company's technology platform. There can be no assurance that the Company will be able to establish such additional collaborations on favourable terms, if at all, or that its current or future collaborative arrangements will be successful.

Should any collaborative partner fail to successfully develop or commercialize any product or product candidate to which it has rights, or any of the partners' products or product candidates to which the Company has rights, its business may be adversely affected. In addition, while the Company believes that its actual and eventual collaborative partners will have sufficient economic motivation to continue their funding, there can be no assurance that any of these collaborations will be continued or will result in successfully commercialized products or product candidates. Failure of a collaborative partner to continue funding any particular program could delay or halt the development or commercialization of any products or product candidates arising out of such program. In addition, there can be no assurance that the collaborative partners will not pursue alternative technologies or develop alternative products or product candidates either on their own or in collaboration with others, including the Company's competitors.

Hazardous Materials: Environmental Matters

The Company's discovery and development processes involve the controlled use of hazardous and radioactive materials. The Company is subject to federal, provincial and local laws and regulations governing the use, manufacture, storage, handling and disposal of such materials and certain waste products. Although the Company believes that its safety procedures for handling and disposing of such materials comply with the standards prescribed by such laws and regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, the Company could be held liable for any damages that result and any such liability could exceed its financial capabilities. The Company is not specifically insured with respect to this liability. Although the Company believes that it is in compliance with applicable environmental laws and regulations in all material respects and currently does not expect to make material capital expenditures for environmental control facilities in the near-term, there can be no assurance that the Company will not be required to incur significant costs to comply with environmental laws and regulations in the future, or that current or future environmental laws or regulations will not have a material adverse affect on its operations, business or assets.

Income Tax Matters

The Company has determined that it was eligible for investment tax credits on expenditures incurred on scientific research and experimental development. There is a risk that: (i) the governmental agency could conclude that: (i) some or all of the

expenditures were not incurred on scientific research and experimental development activities, and (ii) the rate applicable to such credit is different from the rate claimed by the Company, and, therefore the governmental agency could reduce or disallow claims for such credits, including refundable credits.

Growth Management

Rapid growth in any area of the Company's business could place a significant strain on its managerial, operational and technical resources. The Company expects operating expenses and staffing levels to increase in the future. To manage its growth, the Company must expand its operational and technical capabilities and manage its employee base while effectively administering multiple relationships with various third parties. There can be no assurance that the Company will be able to manage its expanding operations effectively. Any failure to implement cohesive management and operating systems, add resources on a cost-effective basis or properly manage the Company's expansion could have a material adverse effect on its business and results of operations.

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the Company. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by these forward-looking statements. We consider the assumptions on which these forward-looking statements are based to be reasonable, but caution the reader that these assumptions regarding future events, many of which are beyond our control, may ultimately prove to be incorrect since they are subject to risks and uncertainties that affect us. The information contained herein is dated as of March 23, 2010, date of the Board's approval for the MD&A and the Consolidated Financial Statements.

On behalf of management,

(signed)

Pierre Labbé, CA
Vice-president and Chief Financial Officer

March 23, 2010

(signed)

Andrew J. Sheldon
President and chief executive officer

Medicago Inc.

Consolidated Financial Statements
December 31, 2009 and 2008

Auditors' Report

To the Shareholders of Medicago Inc.

We have audited the consolidated balance sheets of **Medicago Inc.** as at December 31, 2009 and 2008 and the consolidated statements of earnings and comprehensive loss, deficit, accumulated other comprehensive income (loss) and contributed surplus and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP¹

Quebec City, Quebec, Canada
March 23, 2010

¹ Chartered accountant auditor permit No. 7451

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

Medicago Inc.

Consolidated Balance Sheets

As at December 31, 2009 and 2008

	2009 \$	2008 \$
Assets		
Current assets		
Cash and cash equivalents (note 15c)	228,039	1,091,347
Short-term investments (note 4)	14,105,198	12,936,773
Accounts receivable (note 5)	300,566	181,587
Investment tax credits receivable (note 8)	2,097,274	1,428,289
Grants receivable	37,272	44,750
Prepaid expenses	96,848	76,962
	<hr/>	<hr/>
	16,865,197	15,759,708
Security deposit on a lease agreement , 1.20%, maturing on June 1, 2010 (note 19)	50,000	-
Property, plant and equipment (notes 6, 8 and 11)	4,941,092	4,065,399
Intangible assets (note 7)	974,045	778,512
	<hr/>	<hr/>
	22,830,334	20,603,619
Liabilities		
Current liabilities		
Bank loans (note 8)	600,000	727,950
Accounts payable and accrued liabilities (note 9)	2,301,518	1,314,089
Deferred grant on research agreement (note 10)	340,203	-
Current portion of long-term debt	83,862	73,071
	<hr/>	<hr/>
	3,325,583	2,115,110
Long-term debt (note 11)	15,404,017	15,209,518
	<hr/>	<hr/>
	18,729,600	17,324,628
Shareholders' Equity		
Share capital (note 12)	48,660,207	37,182,667
Contributed surplus	1,554,679	1,087,608
Other equity components (note 13)		
Stock option plan (note 13a)	956,444	500,081
Unit options (note 13b)	399,536	66,640
Warrants (note 13c)	8,919,515	8,410,743
Deficit	(56,395,186)	(43,920,364)
Accumulated other comprehensive income (loss)	5,539	(48,384)
	<hr/>	<hr/>
	4,100,734	3,278,991
	<hr/>	<hr/>
	22,830,334	20,603,619
Commitments (note 19)		
Subsequent events (note 23)		

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors

(signed) RANDAL CHASE, PH.D. Director

(signed) ANDREW J. SHELDON Director
(2)

Medicago Inc.

Consolidated Statements of Deficit, Accumulated Other Comprehensive Income (Loss) and Contributed Surplus

For the years ended December 31, 2009 and 2008

Deficit	2009	2008
	\$	\$
Balance – Beginning of year	(43,920,364)	(36,271,760)
Loss for the year	(12,474,822)	(7,648,604)
Balance – End of year	<u>(56,395,186)</u>	<u>(43,920,364)</u>
Accumulated Other Comprehensive Income (Loss)	2009	2008
	\$	\$
Balance – Beginning of year	(48,384)	-
Other comprehensive income (loss)	53,923	(48,384)
Balance – End of year	<u>5,539</u>	<u>(48,384)</u>
Total deficit and accumulated other comprehensive loss	<u>(56,389,647)</u>	<u>(43,968,748)</u>
Contributed Surplus	2009	2008
	\$	\$
Balance – Beginning of year	1,087,608	802,219
Stock options forfeited	7,883	9,452
Unit options expired	66,640	55,495
Warrants expired	392,548	220,442
Balance – End of year	<u>1,554,679</u>	<u>1,087,608</u>

The accompanying notes are an integral part of these consolidated financial statements.

Medicago Inc.

Consolidated Statements of Earnings and Comprehensive Loss For the years ended December 31, 2009 and 2008

Statements of Earnings

	2009	2008
	\$	\$
Revenues		
Revenues from license agreement	-	2,000,000
Revenues from research agreements	-	444,400
Less: Warrants issued under a licensing agreement	-	(196,136)
	<u>-</u>	<u>2,248,264</u>
Expenses		
Research and development	7,916,776	4,699,188
Research grants and contributions	(352,705)	(83,691)
Research and development tax credits	(668,985)	(920,567)
General and administrative, business development and intellectual property	3,807,113	3,076,133
Stock-based compensation	464,246	245,712
Exchange (gain) loss	(63,719)	7,942
Depreciation of property, plant and equipment	464,046	475,408
Amortization of intangible assets	60,291	99,198
Realized gain on available-for-sale investments	(122,955)	-
Writeoff of intangible assets (note 7)	15,906	572,439
Writeoff of property, plant and equipment (note 6)	30,432	9,897
Financial expenses, net (note 14)	924,376	1,715,210
	<u>12,474,822</u>	<u>9,896,869</u>
Loss for the year	<u>(12,474,822)</u>	<u>(7,648,605)</u>
Basic and diluted loss per share (note 22)	<u>(0.13)</u>	<u>(0.17)</u>

Comprehensive Income (Loss)

	2009	2008
	\$	\$
Loss for the year	<u>(12,474,822)</u>	<u>(7,648,604)</u>
Unrealized gain (loss) on available-for-sale investments	176,878	(48,384)
Reclassification of gain on available-for-sale investments realized upon sale to loss for the year	(122,955)	-
	<u>53,923</u>	<u>(48,384)</u>
Comprehensive loss for the year	<u>(12,420,899)</u>	<u>(7,696,988)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Medicago Inc.

Consolidated Statements of Cash Flows

For the years ended December 31, 2009 and 2008

	2009 \$	2008 \$
Cash flows from operating activities		
Loss for the year	(12,474,822)	(7,648,605)
Items not affecting cash and cash equivalents		
Warrants issued pursuant to licensing agreement and as financing fees	-	454,396
Stock-based compensation costs	464,246	245,712
Depreciation and amortization	524,337	574,606
Amortization of deferred charges	117,499	117,500
Interest capitalized on long-term debt	130,731	713,942
Realized gain on available-for-sale investments	(122,955)	-
Writeoff of intangible assets	15,906	572,439
Writeoff of property, plant and equipment	30,432	9,897
	<u>(11,314,626)</u>	<u>(4,960,113)</u>
Change in non-cash working capital items (note 15a)	473,211	(749,801)
	<u>(10,841,415)</u>	<u>(5,709,914)</u>
Cash flows from financing activities		
Bank loans reimbursed	(127,950)	(22,050)
Non-interest-bearing long-term debt contracted	58,520	-
Payments on long-term debt	(101,460)	(13,072)
Issuance of units	11,592,000	20,785,000
Exercise of warrants	2,362,563	40,625
Issue expenses	(1,176,167)	(635,579)
	<u>12,607,506</u>	<u>20,154,924</u>
Cash flows from investing activities		
Additions to short-term investments	(14,152,696)	(12,985,157)
Disposal of short-term investments	13,161,149	-
Security deposit on a lease agreement	(50,000)	-
Additions to property, plant and equipment	(1,380,646)	(482,698)
Additions to intangible assets	(207,206)	(109,519)
	<u>(2,629,399)</u>	<u>(13,577,374)</u>
Net change in cash and cash equivalents	(863,308)	867,636
Cash and cash equivalents – Beginning of year	<u>1,091,347</u>	<u>223,711</u>
Cash and cash equivalents – End of year	<u>228,039</u>	<u>1,091,347</u>
Additional information (note 15b)		
Interest paid	909,094	702,569

The accompanying notes are an integral part of these consolidated financial statements.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

1 Statutes and nature of activities

The Company was incorporated under Part 1A of the Companies Act (Québec) on July 17, 1997. Since the beginning of its operations, most of the Company's activities have been devoted to research and development. Medicago is a biotechnology company focused on the development and production of vaccines in order to commercialize them in the future using its unique and proprietary manufacturing systems.

2 New accounting standards

Adopted in 2009

On January 1, 2009, the Company adopted Section 3064, "Goodwill and Intangible Assets", of the Canadian Institute of Chartered Accountants ("CICA") Handbook. This section establishes standards for the recognition, measurement and disclosure applicable to intangible assets. It replaces Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". The adoption of this new standard had no significant impact on the financial position and results of operations of the company.

In January 2009, the CICA's Emerging Issue Committee ("EIC") issued Abstract EIC-173, "Credit Risk and the Fair Value of Financial Assets and Liabilities", which requires entities to take both counterparty credit risk and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives. EIC-173 will be effective for interim and annual periods beginning on or after January 1, 2009. The adoption of this guidance had no significant impact on the consolidated financial statements.

In June 2009, the CICA issued amendments to Section 3862, "Financial Instruments – Disclosures", to improve disclosure requirements on fair value measurement and liquidity risk. The amendments are effective for the Company's December 31, 2009 annual financial statements. As the amendments only concern disclosure requirements, they had no significant impact on results or financial position.

Future accounting changes

In January 2009, the CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

- (a) Section 1582, "Business Combinations", which replaces the former Section 1581 with the same title, establishes accounting standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS3, "Business Combinations".
- (b) Section 1601, "Consolidated Financial Statements", which replaces the former Section 1600 with the same title, establishes standards for the preparation of consolidated financial statements.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

- (c) Section 1602, "Non-Controlling Interests". This new section establishes standards on accounting for non-controlling interests in a subsidiary in consolidated financial statements prepared subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements".

The Company is currently evaluating the impact of these new standards on its financial statements.

3 Summary of significant accounting policies

Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The Company's significant accounting policies are summarized as follows:

Basis of consolidation

On April 1, 2007, the Company completed a corporate reorganization resulting in the creation of new entities to perform all of its research and development activities. Consequently, the consolidated financial statements include the accounts of Medicago Inc. and those of Medicago R&D Inc., 9177-4083 Québec Inc., 9157-4265 Québec Inc., Fiducie Financière Medicago and Medicago Europa SAS.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities reported in the financial statements. Those estimates and assumptions also affect the disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the year. Significant estimates include the fair value of financial instruments, the amount of tax credits recoverable, the useful lives of property, plant and equipment and intangible assets, the valuation of long-lived assets, the valuation allowance for future income taxes, the amount of certain accrued liabilities and deferred grant on research agreement. Actual results could differ from those estimates.

Foreign currency translation

Foreign subsidiary

Medicago Europa SAS, the Company's subsidiary, is considered to be an integrated foreign entity. As a result, this foreign subsidiary's accounts are translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at the average exchange rate for the year. Exchange gains or losses resulting from translation are reflected in the statements of earnings.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

Foreign currency transactions

Transactions denominated in foreign currencies are translated into Canadian dollars as follows: monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the average exchange rate for the year. Non-monetary assets and liabilities are translated at historical rates. Exchange gains or losses resulting from translation are reflected in the statements of earnings.

Financial instruments

Financial assets and liabilities are initially recognized at fair value and subsequently recognized according to their classification as described below. The classification depends on the intention with which the financial instruments were acquired and their characteristics and designation by the Company. Unless in the presence of specific circumstances, the classification is not modified following initial recognition.

Cash	Held-for-trading
Cash equivalents	Available for sale
Short-term investments	Available for sale
Interest and other receivables	Loans and receivables
Grants receivable	Loans and receivables
Security deposit	Available for sale
Bank loans	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities

Assets and liabilities held for trading

Financial instruments classified as assets or liabilities held for trading are recognized at fair value at each balance sheet date, and any change in the fair value is reflected in net earnings in the period during which these changes take place.

Loans and receivables and other financial liabilities

Financial instruments classified as loans and receivables and other financial liabilities are accounted for at amortized cost using the effective interest rate method. Interest income or expense is included in net earnings over the expected life of the financial instrument.

Available-for-sale assets

Financial instruments classified as available for sale are recorded at fair value and the gain/loss resulting from the revaluation at the end of each period is recognized as comprehensive income. Securities available for sale that do not have a readily available price quoted on an active market are recognized at cost. Available-for-sale securities are reduced to fair value (recognition of a loss in earnings) when it is necessary to reflect a permanent decline in value. Upon derecognition, all gains or losses cumulated in accumulated other comprehensive income are reflected in net earnings.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

Transaction costs

Transaction costs related to financial instruments that are not classified as held for trading are recognized on the balance sheet as an adjustment to the cost of the financial instrument upon initial recognition and amortized using the effective interest rate method.

Fair value

Amendments to Section 3862, "Financial Instruments – Disclosures", establish a fair value hierarchy which requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company primarily applies the market approach for recurring fair value measurements. The Section describes three input levels that may be used to measure fair value:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

	Level 1	Level 2	Level 3	Total
Assets				
Cash	228,039	-	-	228,039
Short-term investments	14,105,198	-	-	14,105,198
	<u>14,333,237</u>	<u>-</u>	<u>-</u>	<u>14,333,237</u>

For fiscal year ended December 31, 2008, the Company had no Level 3 financial instruments.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks and as well as all highly liquid short-term investments having a term of less than three months at the acquisition date.

Short-term investments

Short-term investments consist primarily of term deposits, bonds and discount notes that do not meet the definition of cash and cash equivalents.

Transactions are recorded on the settlement date and investments are recognized at fair value.

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of related tax credits and accumulated depreciation. Depreciation is calculated using the following methods, period and annual rates:

	Methods	Period and rates
Production unit	Straight-line	5%
Leasehold improvements	Straight-line	Lease term
Computer equipment	Declining balance	30%
Laboratory equipment	Declining balance	30%
Office furniture	Declining balance	20%

Intangible assets

Intangible assets consist of a license, patents and software. The license and patents represent the costs, including professional fees, incurred for the registration of trademarks for product marketing and manufacturing purposes, net of related government grants and accumulated amortization. The license and patents are amortized using the straight-line method over their estimative useful lives of twenty years. Software is recorded at cost, net of related tax credits. Amortization is calculated using the straight-line method at an annual rate of 33%.

Impairment of long-lived assets

Long-lived assets are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the asset is greater than the pre-tax undiscounted future cash flows expected to be provided by the asset. The amount of impairment loss, if any, is the excess of the carrying value of the asset over its fair value.

Share issue expenses

Share issue expenses are applied against share capital.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between the carrying amounts and tax bases of the assets and liabilities. Changes in the future income tax assets or liabilities are included in the statements of earnings. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to be in effect for the year in which the differences are expected to reverse.

The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

Research and development costs

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research activities are expensed as incurred. Development expenses which meet generally accepted criteria for deferral are capitalized and amortized against earnings over the estimated period of benefit. As at December 31, 2009 and 2008, no development costs have been deferred.

Research and development tax credits and grants

The Company is entitled to scientific research and experimental development ("SR&ED") tax credits granted by the Canadian federal government and the government of the Province of Québec.

SR&ED tax credits and grants are accounted for using the cost reduction method. Accordingly, tax credits and grants are recorded as a reduction of the related expenses or capital expenditures in the year in which those expenses are incurred, provided there is reasonable assurance that the credits and grants will be realized.

Revenue recognition

Revenues related to research agreements are bound to milestone agreements and are recorded as the milestones are reached and upon customer acceptance. Under these agreements, the payments received in advance are recognized as deferred revenue in the balance sheet and then, as revenue when milestones are reached and upon customer acceptance. Revenue from research agreements are recognized using the percentage-of-completion method.

The existing licensing agreements usually foresee one-time payment (upfront payment) and milestone payments. Revenues associated with those multiple-element arrangements are allocated to the various elements based on their relative fair value. Agreements containing multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered obligation(s). The consideration received is allocated among the separate units based on each unit's fair value or using the residual method, and the applicable revenue recognition criteria are applied to each of the separate units.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

License fees representing non-refundable payments received upon the execution of license agreements are recognized as revenue upon execution of the license agreements when the Company has no significant future performance obligations and collectability of the fees is assured. Upfront payments received at the beginning of licensing agreements are not recorded as revenue when received but are amortized based on the progress of the related research and development work. This progress is based on estimates of total expected time or duration to complete the work which is compared to the period of time incurred to date in order to arrive at an estimate of the percentage of revenue earned to date.

Stock-based compensation and other stock-based payments

The Company has a stock option plan which is described in note 13. The fair value of stock options is determined using the Black-Scholes option pricing model and stock-based compensation costs are recognized over the vesting period of the options and are recorded in Shareholders' Deficiency under caption "Other equity components". Any consideration received by the Company on the exercise of stock options and the carrying value of those stock options are recorded in Shareholders' Equity under caption "Share capital" upon the issuance of shares.

Basic and diluted earnings per share

Basic earnings per share are determined using the weighted average number of participating shares outstanding during the year.

Diluted earnings per share are determined using the weighted average number of participating shares outstanding during the year, plus the effects of dilutive potential participating shares outstanding during the year. The calculation of diluted earnings per share is made using the treasury stock method, as if all dilutive potential shares had been exercised at the later of the beginning of the year or the issuance date, as the case may be, and that the funds obtained thereby be used to purchase participating shares of the Company at the average market value of the participating shares during the year.

Comparative figures

Certain comparative figures have been reclassified to conform with the current year presentation.

4 Short-term investments

	2009 \$	2008 \$
Term deposits bearing interest at annual rates ranging from 0.75% to 1.40%, maturing in December 2010	9,600,000	6,000,000
Bonds and discount notes, bearing interest at effective annual rates ranging from 3.70% to 4.00%, maturing until June 2015	3,248,485	6,557,575
Money market funds	1,256,713	379,198
	<hr/> 14,105,198	<hr/> 12,936,773

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

5 Accounts receivable

	2009 \$	2008 \$
Commodity taxes receivable	272,207	98,266
Interest receivable	8,359	67,346
Other receivables	20,000	15,975
	<u>300,566</u>	<u>181,587</u>

6 Property, plant and equipment

	2009		2008	
	Cost \$	Accumulated depreciation \$	Cost \$	Accumulated depreciation \$
Land	491,840	-	491,840	-
Production unit	3,765,160	827,564	3,490,335	653,047
Leasehold improvements	321,306	302,506	302,506	302,506
Computer equipment	183,483	80,136	102,395	58,246
Laboratory equipment	2,668,489	1,346,213	2,315,003	1,654,690
Office furniture	222,270	155,037	174,280	126,388
	<u>7,652,548</u>	<u>2,711,456</u>	<u>6,876,359</u>	<u>2,794,877</u>
Research and development tax credits	(123,038)	(123,038)	(123,038)	(106,955)
	<u>7,529,510</u>	<u>2,588,418</u>	<u>6,753,321</u>	<u>2,687,922</u>
Less: Accumulated depreciation	<u>2,588,418</u>		<u>2,687,922</u>	
Net amount	<u>4,941,092</u>		<u>4,065,399</u>	

In 2009, laboratory equipment with a carrying value of \$30,432 (computer equipment with a carrying value of \$9,897 in 2008) was written off since it was no longer in use.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

7 Intangible assets

	2009		2008	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
License	68,966	11,873	68,966	8,423
Patents	1,220,360	303,510	965,826	249,716
Software	57,659	57,557	57,659	55,800
	1,346,985	<u>372,940</u>	1,092,451	<u>313,939</u>
Less: Accumulated amortization	<u>372,940</u>		<u>313,939</u>	
Net amount	<u>974,045</u>		<u>778,512</u>	

In 2009, five patents with a net carrying value of \$15,906 were written off since they were no longer in use. In 2008, the writeoff included a licence that was no longer in use for a total amount of \$572,439.

8 Bank loans

	2009 \$	2008 \$
Bearing interest at prime rate plus 0.75% annually, repayable at the earlier of the following: upon receipt of tax credits or on June 30, 2010, secured by a senior charge over investment tax credits and by a junior charge over other property, plant and equipment and intellectual property of the Company and also guaranteed by the chief executive officer	600,000	342,950
Reimbursed during 2009	-	385,000
	<u>600,000</u>	<u>727,950</u>

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

9 Accounts payable and accrued liabilities

	2009 \$	2008 \$
Accounts payable	1,382,987	586,628
Salaries and fringe benefits	601,417	395,301
Accrued liabilities	159,358	174,404
Tax credit payable	157,756	157,756
	<u>2,301,518</u>	<u>1,314,089</u>

10 Deferred grant on research agreement

The Company is entitled to a contribution from Québec's Consortium for Drug Discovery ("CQDM") of up to \$1.77 M. As at December 31, 2009, the Company received a sum of \$477,869 of which an amount of \$137,666 is presented as research grants and contributions and an amount of \$340,203 as deferred grant.

11 Long-term debt

	2009 \$	2008 \$
Loan from Investissement Québec ("Bio-Levier"), bearing interest at prime rate plus 3%, payable annually at a rate of 25% of net earnings plus depreciation and amortization generated in the preceding year over a period ending no later than December 21, 2014, secured by a senior fixed and floating charge of \$16,000,000 over all property, plant and equipment and intellectual property of the Company	(a) 15,318,648	15,318,648
Deferred financing expenses	(585,692)	(703,191)
Discounted at a rate of 20%, refundable contribution granted under the Technology Partnerships Canada program	(b) 553,850	461,542
Discounted at a rate of 20%, contribution under an innovation program, payable in annual instalments of \$60,000 until September 2013	170,942	193,742
Loan bearing interest at 8%, payable in monthly payments of \$2,118, including principal and interest, maturing in March 2011	30,131	-
Reimbursed in 2009	-	11,848
	<u>15,487,879</u>	<u>15,282,589</u>
Less: Current portion	<u>83,862</u>	<u>73,071</u>
	<u>15,404,017</u>	<u>15,209,518</u>

- (a) On July 28, 2003, the Company signed a loan agreement of \$12,000,000 with Investissement Québec ("IQ") under the Bio-Levier Program. As at December 31, 2009, the Company has used \$12,000,000 plus capitalized interest of \$3,318,648.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

The terms and conditions of the loan agreement are as follows:

- (i) For the first three years, the Company deferred the principal instalments and capitalized interest. Interest is payable on a monthly basis. In March 2008, IQ agreed to capitalize 50% of the interest payable for 2008. In consideration for this, Medicago issued 643,877 warrants to purchase an equivalent number of common shares, at a price of \$0.70 per share, for a period of three years. The fair value of \$258,260 has been recorded as financial expenses in 2008.
 - (ii) The interest rate may be converted into a fixed rate.
 - (iii) At the Company's request, and under certain conditions, IQ may release the fixed and floating senior charge on any selected intellectual property in the event the Company executes a license agreement, a commercialization agreement or an operating agreement.
 - (iv) Under the terms of the agreement in 2004, the Company has granted IQ 1,426,819 warrants for the purchase of common shares at a price of \$1.12, each expiring on August 30, 2011.
 - (v) Under the terms of the agreement, the Company undertook to meet a current ratio exceeding 1.3:1. As at December 31, 2009, the current ratio is 5.07:1 (7.45:1 in 2008).
- (b) Under the federal contribution program called Technology Partnerships Canada ("TPC"), the Company received a refundable contribution equivalent to 33% of the eligible expenses incurred by the Company in the optimization and scale-up of its production unit for a total amount of \$834,635 as at December 31, 2009 (\$834,635 as at December 31, 2008). Royalties of 2% on gross cash proceeds of any kind will be payable from January 1, 2010 based on gross cash proceeds of the prior year. These royalties will be payable at the earlier of the complete repayment of the contribution or by January 1, 2020; subsequent to this date, no further payments will be required.

The principal instalments for each of the next five years, excluding IQ loan, are as follows:

	\$
2010	83,862
2011	66,269
2012	60,000
2013	60,000
2014	15,318,648

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

12 Share capital

The authorized share capital of the Company is as follows:

Authorized

Unlimited number of shares, without par value, of the following classes:

Common shares, voting and participating

Preferred shares, with rights, privileges and conditions to be determined by the Board of Directors before issuance

The share capital issued has varied as follows:

	For the years ended December 31,			
	2009		2008	
	Number	\$	Number	\$
Common shares				
Balance – Beginning of year	90,324,940	37,182,667	21,112,440	23,465,147
Issued pursuant to a public offering	(i) 16,100,000	9,980,328	-	-
Issued pursuant to private placements	(ii), (iii), (iv) -	-	69,050,000	14,207,918
Issued pursuant to the exercise of warrants	8,346,750	2,853,892	162,500	50,586
Issue expenses *	-	(1,356,680)	-	(540,984)
Balance – End of year	114,771,690	48,660,207	90,324,940	37,182,667

* Issue expenses were shared out between common shares and warrants pro rata to their fair value.

- (i) On December 14, 2009, the Company issued 16,100,000 units at a price of \$0.72 per unit for total gross proceeds of \$11,592,000 ("the 2009 Public Offering"). Each unit consists of one common share of the Company and one half common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$1.00 for twelve months following the issuance of the warrant.

The gross proceeds of the 2009 Public Offering amounting to \$11,592,000 are shared out between the 16,100,000 common shares for a gross amount of \$9,980,328 and the 8,050,000 warrants attached to each unit for a gross amount of \$1,611,672 (note 13c). In connection with this financing, the Company paid a cash compensation equivalent to 7% of the gross proceeds of the financing, being \$811,440. The Company also granted non-transferable unit options to the agents entitling to subscribe, before November 26, 2010, for 1,127,000 units at a price of \$0.72 per unit as financing expenses (note 13b). Each unit consists of one common share of the Company and one half common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$1.00. The issue expense for the Company regarding this financing totalled \$1,575,703.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

- (ii) On October 21, 2008, the Company issued 45,000,000 units at a price of \$0.355 per unit for total gross proceeds of \$15,975,000 ("the October Private Placement"). Each unit consists of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$0.375 for the first year following the issuance of the warrant and \$0.405 for the second year.

The gross proceeds of the October Private Placement of \$15,975,000 are shared out between the 45,000,000 common shares for a gross amount of \$10,183,385 and the 45,000,000 warrants attached to each unit for a gross amount of \$5,791,615 (note 13c). The issue expense for the Company regarding this investment amounted to \$301,138.

- (iii) On August 29, 2008, the Company issued 11,050,000 units at a price of \$0.20 per unit for total gross proceeds of \$2,210,000 ("the August Private Placement"). Each unit consists of one common share of the Company and one-half common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$0.30 for a period of twelve months.

The gross proceeds of the August Private Placement of \$2,210,000 are shared out between the 11,050,000 common shares for a gross amount of \$1,866,533 and the 5,525,000 warrants attached to each unit for a gross amount of \$343,467 (note 13c). The issue expense for the Company regarding this investment totalled \$162,817.

- (iv) On March 14, 2008, the Company issued 13,000,000 units at a price of \$0.20 per unit for total gross proceeds of \$2,600,000 ("the March Private Placement"). Each unit consists of one common share of the Company and one-half common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$0.25 for a period of twenty-four months.

The gross proceeds of the March Private Placement of \$2,600,000 are shared out between the 13,000,000 common shares for a gross amount of \$2,158,000 and the 6,500,000 warrants attached to each unit for a gross amount of \$442,000 (note 13c). The issue expense for the Company regarding this investment totalled \$254,913.

13 Other equity components

- (a) Stock option plan

Under the Company's stock option plan (the "Plan"), the Board of Directors may, from time to time, at its discretion, and in accordance with the Exchange requirements, grant non-transferable options to purchase common shares of the Company (an "option"). On January 14, 2009, the Company's Board of Directors approved an increase of 4,500,000 shares issuable under the plan, thus increasing the maximum number issuable to 9,000,000 shares.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

The Board of Directors may grant options to directors, officers, key employees and consultants of the Company expiring after a maximum period of ten years. The number of common shares that may be issued (i) to any one individual, in any 12-month period, cannot exceed 5% of the total number of issued and outstanding common shares; (ii) to any consultant, in any 12-month period, cannot exceed 2% of the total number of issued and outstanding common shares; and (iii) to any employee who provides investor relations services, in any 12-month period, cannot exceed 2% of the total number of issued and outstanding common shares. Except as the Board of Directors may otherwise decide upon the grant of an option, the options are vested and may only be exercised as follows: (i) 1/3 of the options upon the first anniversary of the grant; (ii) 1/3 of the options upon the second anniversary of the grant; and (iii) 1/3 of the options upon the third anniversary of the grant.

The following table summarizes the stock option activity since January 1, 2008:

	For the years ended December 31,					
	2009			2008		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding – Beginning of year	2,344,595	500,081	0.89	1,415,958	263,821	1.10
Granted	4,797,830	-	0.39	965,968	-	0.59
Forfeited	(50,833)	(7,883) *	0.83	(37,331)	(9,452) *	1.00
Compensation costs for the year	-	464,246	-	-	245,712	-
Outstanding – End of year	<u>7,091,592</u>	<u>956,444</u>	<u>0.55</u>	<u>2,344,595</u>	<u>500,081</u>	<u>0.89</u>
Options exercisable – End of year	<u>2,709,094</u>	<u>-</u>	<u>0.75</u>	<u>1,046,954</u>	<u>-</u>	<u>1.12</u>

* During fiscal 2009, 50,833 stock options were forfeited (37,331 in 2008). The corresponding credit amounting to \$7,833 (\$9,452 in 2008) has been recorded as contributed surplus.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

The following table summarizes information about outstanding and exercisable stock options as at December 31, 2009:

Exercise price	Stock options outstanding			Stock options currently exercisable	
	Number	Weighted average remaining contractual life (months)	Weighted average exercise price \$	Number	Weighted average exercise price \$
\$0.20	2,052,650	48	0.20	-	-
\$0.355	1,420,000	48	0.355	1,075,000	0.355
\$0.37	223,674	44	0.37	74,558	0.37
\$0.52 to 0.66	829,794	42	0.64	255,742	0.66
\$0.72	1,237,680	120	0.72	-	-
\$1.00 to 1.11	1,175,706	17	1.04	1,151,706	1.04
\$1.68	152,088	18	1.68	152,088	1.68
	<u>7,091,592</u>	<u>54</u>	<u>0.55</u>	<u>2,709,094</u>	<u>0.75</u>

Assumptions used in determining stock-based compensation costs

The table below shows the weighted average assumptions used in determining stock-based compensation costs under the Black-Scholes option pricing model:

	2009	2008
Dividend yield	Nil	Nil
Expected volatility	98.74%	95%
Risk-free interest rate	2.01%	3.06%
Expected life (years)	4.97	5.00
Weighted average fair value of stock options granted at market price at the date of the grant (\$)	0.41	0.40
Weighted average fair value of stock options granted at a price higher than the market price at the date of the grant (\$)	0.23	0.42
Stock-based compensation costs	464,246	245,712

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

(b) Unit options

The following table summarizes the unit option activity since January 1, 2008:

	For the years ended December 31,					
	2009			2008		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding and exercisable – Beginning of year	280,000	66,640	0.50	420,268	122,135	0.67
Granted to the agent pursuant to a public placement	1,127,000	399,536	0.72	-	-	-
Expired *	(280,000)	(66,640)	0.50	(140,268)	(55,495)	1.00
Outstanding and exercisable – End of year	1,127,000	399,536	0.72	280,000	66,640	0.50

* During fiscal 2009, 280,000 unit options expired (140,268 in 2008). The corresponding credit amounting to \$66,640 (\$55,495 in 2008) has been recorded as contributed surplus.

The following table summarizes information about unit options outstanding and exercisable as at December 31, 2009:

Exercise price	Number	Weighted average remaining contractual life (years)
\$0.72	1,127,000	0.92

The fair value of unit options was estimated using the Black-Scholes valuation model with the following assumptions:

	2009
Dividend yield	Nil
Expected volatility	119.55%
Risk-free interest rate	0.54%
Expected life (years)	1
Fair value of unit options granted (\$)	0.354

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(c) Warrants

The following table summarizes the warrant activity since January 1, 2008:

	For the years ended December 31,					
	2009			2008		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding and exercisable – Beginning of year	64,933,196	8,410,743	0.39	7,430,653	1,787,553	1.05
Granted at the signing of a non-exclusive license agreement	-	-	-	2,000,000	196,136	0.23
Granted to the subscribers in connection with public offering	8,050,000	1,611,672	1.00	-	-	-
Granted to the subscribers in connection with private placements	-	-	-	57,025,000	6,577,082	0.35
Granted to IQ (see note 11(a) (i))	-	-	-	643,877	258,260	0.70
Exercised	(8,346,750)	(491,329)	0.28	(162,500)	(9,961)	0.25
Expired *	(4,007,500)	(392,548)	0.75	(2,003,834)	(220,442)	1.10
Warrant issue expenses	-	(219,023)	-	-	(177,885)	-
Outstanding and exercisable – End of year	<u>60,628,946</u>	<u>8,919,515</u>	<u>0.49</u>	<u>64,933,196</u>	<u>8,410,743</u>	<u>0.39</u>

* During fiscal year 2009, 4,007,500 warrants expired (2,003,834 in 2008). The corresponding credit, amounting to \$392,548 (\$220,442 in 2008), has been recorded as contributed surplus.

The following table summarizes the information relating to warrants outstanding and exercisable as at December 31, 2009:

Exercise price	Number	Weighted average remaining contractual life (years)
\$0.25	5,508,250	0.53
\$0.405	45,000,000	0.81
\$0.70	643,877	1.34
\$1.00	8,050,000	0.90
\$1.12	1,426,819	1.66
	<u>60,628,946</u>	<u>0.82</u>

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

The fair value of warrants was estimated using the Black-Scholes valuation model with the following weighted average assumptions:

	2009	2008
Dividend yield	Nil	Nil
Expected volatility	119.55%	129%
Risk-free interest rate	0.54%	2.31%
Expected life (years)	1	1.95
Fair value of warrants granted (\$)	0.20	0.118

14 Financial expenses, net

	2009	2008
	\$	\$
Interest on long-term debt	970,483	1,292,356
Interest and bank charges	87,361	114,016
Amortization of deferred financing expenses	117,499	117,500
Warrants issued as financing fees	-	258,260
Interest income	(250,967)	(66,922)
	<hr/>	<hr/>
	924,376	1,715,210
	<hr/>	<hr/>

15 Additional information on cash flows

(a) Change in non-cash working capital items

	2009	2008
	\$	\$
Accounts receivable	(118,979)	(75,643)
Investment tax credits receivable	(668,985)	(584,044)
Grants receivable	7,478	-
Prepaid expenses	(19,886)	16,001
Accounts payable and accrued liabilities	933,380	188,285
Deferred grant on research agreement	340,203	-
Deferred revenue	-	(294,400)
	<hr/>	<hr/>
	473,211	(749,801)
	<hr/>	<hr/>

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

(b) Items not affecting cash related to financing and investing activities

	2009	2008
	\$	\$
Warrants transferred to share capital upon exercise	491,329	9,961
Share issue expenses included in accounts payable and accrued liabilities	-	83,290
Acquisition of property, plant and equipment in accounts payable and accrued liabilities	-	10,475
Acquisition of intangible assets in accounts payable and accrued liabilities	116,102	51,578

(c) Cash and cash equivalents

	2009	2008
	\$	\$
Cash	228,039	41,347
Cash equivalents	-	1,050,000
	<u>228,039</u>	<u>1,091,347</u>

16 Income taxes

The reconciliation of the income tax provision calculated using the combined Canadian federal and provincial statutory income tax rate with the income tax provision in the financial statements is as follows:

	2009	2008
Combined Canadian federal and provincial statutory tax rate	<u>30.90%</u>	<u>30.90%</u>
Income tax recovery based on statutory income tax rates	\$ (3,837,989)	\$ (2,359,717)
Non-deductible expenses	166,167	164,599
Non-taxable items	(92,612)	(133,510)
Difference between statutory and future tax rates	524,133	322,429
Change in valuation allowance	2,824,225	1,822,376
Items not affecting earnings	(363,436)	(222,130)
Expiry of loss carry-forwards	591,944	512,463
Prior years' adjustments	190,387	(100,934)
Other	(2,819)	(5,576)
	<u>\$ -</u>	<u>\$ -</u>

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

The significant components of the Company's future income tax assets and liabilities are as follows:

	2009 \$	2008 \$
Future income tax assets		
Current future income tax assets		
Other	-	-
Long-term future income tax assets		
Property, plant and equipment	47,488	65,043
Intangible assets	260,568	289,406
Research and development expenses	5,424,897	4,060,763
Non-capital losses	8,152,895	6,917,029
Financing expenses	310,106	142,091
Federal contribution	292,658	225,915
Other	2,598	3,303
	<u>14,491,210</u>	<u>11,703,550</u>
	14,491,210	11,703,550
Valuation allowance	<u>(14,397,103)</u>	<u>(11,572,878)</u>
Total future income tax assets	<u>94,107</u>	<u>130,672</u>
Future income tax liabilities		
Long-term future income tax liabilities		
Long-term debt	<u>(94,107)</u>	<u>(130,672)</u>
Total future income tax liabilities	<u>(94,107)</u>	<u>(130,672)</u>
Future income taxes, net	<u>-</u>	<u>-</u>

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

As at December 31, 2009, the Company has accumulated, for federal and provincial income tax purposes, non-capital losses amounting to approximately \$33,500,000 (\$27,771,000 in 2008) and \$26,136,000 (\$22,954,000 in 2008), respectively. These losses can be carried forward against future years' taxable income and will expire as follows:

	Federal \$	Provincial \$
2014	4,500,000	3,847,000
2015	5,450,000	3,943,000
2026	6,966,000	5,788,000
2027	3,722,000	3,154,000
2028	4,496,000	2,079,000
2029	8,366,000	7,322,000
	<u>33,500,000</u>	<u>26,133,000</u>

The Company is entitled to a non-refundable federal tax credit of approximately \$2,139,000. This credit can be applied against future years' taxable income and will expire at the latest in 2029.

17 Segment information

The Company is organized under one single business segment, being the research and development of vaccines. Substantially all of the Company's property, plant and equipment and intangible assets are located in Canada.

All revenues for fiscal year 2008 have been allocated based on the location in which the sale originated. All of them have been generated in Canada.

18 Economic dependence

One client represents 100% of the revenues in 2008.

19 Commitments

As at December 31, 2009, the balance of commitments on lease agreements for premises amounts to \$925,085. Minimum rental amounts for each of the next five fiscal years are as follows: \$213,749 in 2010, \$264,510 in 2011, \$263,043 in 2012, \$144,111 in 2013 and \$39,672 in 2014. The main lease for premises expires in August 2013 with a renewal option of five years.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

In order to secure the payment of the rent and compliance with the terms and conditions of the lease agreement for the premises, the Company's financial institution signed a letter of credit for an amount of \$50,000 in favour of the lessor. A term deposit of \$50,000 has been given as security for this letter.

Under a license obtained from Agriculture and Agri-Food Canada, the Company is committed to paying royalties. The minimum royalties for the next 8 years amount to \$50,000 per year from 2010 to 2017.

Under a license from the University of Guelph, the Company is committed to paying royalties. The minimum royalties for the next five years amount to \$5,000 per year from 2010 to 2014.

Under a license, the Company is committed to paying royalties. The minimum royalties for the next five years amount to \$97,000 per year from 2010 to 2014.

20 Capital management

The Company views capital as the sum of long-term debt and Shareholders' Equity.

The Company's objectives when managing capital is to safeguard the Company's ability to continue as a going concern in order to provide an adequate return to shareholders and maintain a sufficient level of funds to finance its research and development activities, general and administrative expenses, working capital and overall capital expenditures, including those associated with patents and trademarks.

To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets, all of which are subject to market conditions and the terms of the underlying third party agreements.

The Company is not subject to any capital requirements imposed by a regulator.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

The total capital as at December 31, 2009 and 2008 is calculated as follows:

	2009 \$	2008 \$
Long-term debt	15,404,017	15,209,518
Current portion of long-term debt	83,862	73,071
	<hr/> 15,487,879	<hr/> 15,282,589
Share capital	48,660,207	37,182,667
Contributed surplus	1,554,679	1,087,608
Other equity components		
Stock option plan	956,444	500,081
Unit options	399,536	66,640
Warrants	8,919,515	8,410,743
Deficit	(56,395,186)	(43,920,364)
Accumulated other comprehensive gain (loss)	5,539	(48,384)
	<hr/> 4,100,734	<hr/> 3,278,991
Total capital	<hr/> 19,588,613	<hr/> 18,561,580

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

21 Financial instruments

Fair value

The following tables summarize the fair value of financial instruments as at December 31, 2009 and 2008:

	<u>As at December 31, 2009</u>					
	<u>Held for trading</u>	<u>Available for sale</u>	<u>Loans and receivables</u>	<u>Other financial liabilities</u>	<u>Carrying value</u>	<u>Fair value</u>
	\$	\$	\$	\$	Total \$	Total \$
Financial assets						
Cash	228,039	-	-	-	228,039	228,039
Short-term investments	-	14,105,198	-	-	14,105,198	14,105,198
Accounts receivable	-	-	28,359	-	28,359	28,359
Grants receivable	-	-	37,272	-	37,272	37,272
Security deposit	-	50,000	-	-	50,500	50,500
	<u>228,039</u>	<u>14,155,198</u>	<u>65,631</u>	<u>-</u>	<u>14,449,368</u>	<u>14,449,368</u>
Financial liabilities						
Bank loans	-	-	-	600,000	600,000	600,000
Accounts payable and accrued liabilities	-	-	-	2,235,849	2,235,849	2,235,849
Long-term debt	-	-	-	15,487,879	15,487,879	16,073,571
	<u>-</u>	<u>-</u>	<u>-</u>	<u>18,323,728</u>	<u>18,323,728</u>	<u>18,909,420</u>

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

	As at December 31, 2008					
	Held for trading \$	Available for sale \$	Loans and receivables \$	Other financial liabilities \$	Carrying value	Fair value
					Total \$	Total \$
Financial assets						
Cash	18,574	22,773	-	-	41,347	41,347
Cash equivalents	-	1,050,000	-	-	1,050,000	1,050,000
Short-term investments	-	12,936,773	-	-	12,936,773	12,936,773
Accounts receivable	-	-	83,321	-	83,321	83,321
Grants receivable	-	-	44,750	-	44,750	44,750
	<u>18,574</u>	<u>14,009,546</u>	<u>128,071</u>	<u>-</u>	<u>14,156,191</u>	<u>14,156,191</u>
Financial liabilities						
Bank loans	-	-	-	727,950	727,950	727,950
Accounts payable and accrued liabilities	-	-	-	1,156,333	1,156,333	1,156,333
Long-term debt	-	-	-	15,282,589	15,282,589	15,985,780
	<u>-</u>	<u>-</u>	<u>-</u>	<u>17,166,872</u>	<u>17,166,872</u>	<u>17,870,063</u>

Cash and cash equivalents and short-term investments are recorded at fair value. The fair value of other financial instruments, except long-term debt, approximates their carrying value due to their short-term maturity or to current market rates.

Financial risk

The Company is exposed to various types of risks due to the nature of the business activities it carries on, including those related to the use of financial instruments. The Company does not use financial derivatives.

Market risk

Market risk corresponds to the financial losses that the Company could incur because of unfavourable fluctuations in the value of financial instruments, following variations in the parameters underlying their evaluation, such as interest rates and exchange rates.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2009 and 2008

Foreign exchange risk

The exposure to variation of interest rates is described hereunder. Regarding the exposure to foreign exchange rates, the Company operates internationally and some of its expenses are incurred in US dollars and Euros but these exposures are not material.

Interest rate risk

As at December 31, 2009, the Company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Variable interest rate
Short-term investments	Fixed interest rate
Accounts receivable	Non-interest bearing
Grants receivable	Non-interest bearing
Bank loans	Variable interest rate
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 11

Bank loans (note 8) bear interest at variable rates. As at December 31, 2009, fluctuations of 1% in bank loans' interest rates would have a positive or negative impact of \$6,000 on loss and comprehensive loss.

The Bio-Levier loan (note 11) bears interest at a variable rate. As at December 31, 2009, fluctuations of 1% in loan's interest rate would have a positive or negative impact of \$153,186 on loss and comprehensive loss.

Credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments (note 4) and accounts receivable (note 5). Cash and cash equivalents are maintained with high-credit quality financial institutions. Short-term investments consist primarily of term deposits, bonds and residuals issued by high-credit quality institutions. Consequently, management considers the risk of non-performance related to cash and cash equivalents and short-term investments to be minimal.

Accounts receivable, such as interest receivable from Canadian chartered banks and amounts due from employees, are low-risk items.

Liquidity risk

Liquidity risk represents the possibility that the Company may not be able to gather sufficient cash resources, when required and under reasonable conditions, to meet its financial obligations. The Company believes that, with the financial resources currently at its disposal, it has sufficient cash and cash equivalents to meet its contractual liabilities until the first quarter of 2011. To meet all its contractual liabilities, the Company will need to raise additional funds in the future and will seek additional forms of debt or equity financing, but cannot provide assurance that it will be successful in doing so.

Medicago Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

The following table summarizes contractual obligations as at December 31, 2009:

	Net value	Cash flows	0-12	12-24	Thereafter
	\$	\$	months	months	
			\$	\$	\$
Bank loans	600,000	600,000	600,000	-	-
Accounts payable	2,301,518	2,301,518	2,301,518	-	-
Long-term debt	16,073,571	16,423,413	83,862	66,269	16,273,282
	<u>18,975,089</u>	<u>19,324,931</u>	<u>2,985,380</u>	<u>66,269</u>	<u>16,273,282</u>

22 Loss per share

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding used in the diluted loss per share calculations:

	2009	2008
Basic and diluted weighted average number of shares outstanding	93,856,253	44,024,223
Dilutive effect of stock options	1,188,049	2,343
Dilutive effect of warrants	2,104,761	3,034,456
	<u>97,149,063</u>	<u>47,061,022</u>

For the years ended December 31, 2009 and 2008, the diluted loss per share was the same as the basic net loss per share since the dilutive effect of stock options and warrants was not included in the calculation; otherwise the effect would have been anti-dilutive. Accordingly, the diluted loss per share for those periods was calculated using the basic weighted average number of shares outstanding.

Excluded from the 2009 calculation of diluted loss per share were 3,395,268 stock options (2,120,921 in 2008) and 55,120,696 warrants (6,076,696 in 2008) since the exercise prices were greater than the average market price of the common shares for the year.

23 Subsequent events

Between January 1, and March 23, 2010, 3,443,500 warrants at a price of \$0.25 per warrant were exercised for gross proceed amounting to \$860,875.