



April 22, 2008

Dear shareholders,

This was a year of great technical advancement, in which we worked diligently to raise the necessary financial capital that led to the successful attainment of many value creating milestones.

Foremost of these milestones was our successful development of a H5N1 influenza virus vaccine, otherwise known as an Avian Flu vaccine. Our vaccine is comprised of highly immunogenic particles known as virus like particles (VLPs). VLPs have significant advantages over conventional vaccines as they are known to broaden immunity and therefore increase protection against disease. Our competitive advantage lays in the speed with which we can produce vaccines using our patented, plant-based production technology.

We conducted a series of pre-clinical tests and in October 2007 we demonstrated that our H5N1 vaccine elicited a strong protective immune response against disease with doses as low as 1 µg. Further testing has now subsequently demonstrated that we protect up to 100% of mice in a lethal challenge with various deadly H5N1 viruses. From these results, Medicago has established that its candidate vaccine has the potential to protect against three of the deadliest strains of Pandemic H5N1 Influenza viruses circulating today.

The advantages of our technology in preparation for a potential Influenza pandemic have been recognized worldwide, as authorities acknowledge the vulnerability of the world's population with current vaccine supplies. We continue to receive invitations to speak at highly prestigious conferences having just presented at the World Health Organizations closed door conference on Influenza vaccines in December 2007. This continues on in 2008. During the first quarter of 2008, we presented at the World Global Health conference in Washington as well as the International conference on avian influenza in Bangkok.

The value of our technology was further validated in 2007, through the signing of an important collaboration agreement with a Fortune 100 company. Under the terms of this agreement, Medicago and its partner are collaborating to advance our proprietary transient expression system to produce a therapeutic protein. In January 2008, we expanded our partnership with the signing of a second non-exclusive licensing agreement for further development of our proprietary system. Since signing, we have received four non-dilutive upfront or milestone-based payments from our partner, totaling \$2.5 million. We expect that partnerships such as this will continue to generate milestone payments as our technology advances closer to commercialization.

To strengthen our balance sheet, we completed a private placement of \$2 million for four million units of common shares in May 2007; furthermore we completed a subsequent private placement of \$2.6 million in March 2008.

In the coming year, we plan to continue the development of our H5N1 vaccine with the goal of completing a successful Phase I trial in 2009. We will also begin a program to develop a seasonal Influenza vaccine. In addition, we will continue to work with our partners to bring further financing to our company and advance our technology closer to commercialization.

The successes of Medicago in 2007 are a direct result of the dedication and hard work of our employees management and directors. On behalf of the Board of Directors and the management of Medicago, I would like to thank you for your continued support in 2007.

Yours sincerely,

A handwritten signature in blue ink that reads "Andrew J. Sheldon".

Andrew J. Sheldon
President and CEO

YEAR ENDED DECEMBER 31, 2007

MANAGEMENT'S REPORT ON CONSOLIDATED 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 operational results, financial condition and cash flows for the fourth quarter of 2007 and year ended December 31, 2007 and 2006 of Medicago Inc. (the Company). This analysis should be read in conjunction with the information contained in the consolidated financial statements and related notes for years end of December 31, 2007, appearing in the annual report of the Company, which are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

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.

Company Overview

Medicago is committed to provide highly effective and affordable vaccines based on our 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 non-transgenic plants. This technology has potential to offer advantages of speed and cost over competitive technologies. It can deliver a vaccine for testing in less than a month 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.

Going Concern

While the accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, certain adverse conditions and events cast substantial doubt upon the validity of these assumptions. The Company is not yet profitable and has relied mostly on non-operational sources of financing to fund operations. The Company's ability to continue as a going concern will be dependent on management's ability to successfully execute its business plan, which includes an increase in revenue and further product development. The Company seeks additional forms of debt or equity financing, but cannot provide assurance that it will be successful in doing so. These financial statements do not include adjustments or disclosures that may result from the Company's inability to continue as a going concern. If the going concern assumption is not appropriate for these financial statements, then adjustments would be necessary in the carrying value of assets and liabilities and the reported losses and balance sheet classifications used.

Management believes that additional equity or debt-based financing is required to continue the Company's operations. There is no assurance that management will be successful in raising additional funding. However, the Company has successfully completed a private placement of \$2.6 million in March 2008.

Important Events in 2007

Collaboration agreements with an undisclosed Fortune 100 company

In December 2007, Medicago entered into a first collaboration and non-exclusive licensing agreement with an undisclosed Fortune 100 company to develop a product outside of the Company's core development pipeline. Under terms of this agreement, Medicago has collaborated with the Fortune 100 company to advance Medicago's proprietary transient expression system to produce a therapeutic protein with a human-compatible glycosylation pattern. Medicago received a total payment of \$500,000 for this collaboration, \$350,000 in December 2007 and \$150,000 in January 2008.

On February 7, 2008, the company entered into a non-exclusive licensing agreement (the "Agreement") with an undisclosed Fortune 100 Company (the "Partner") for the development and commercialization of the company's proprietary plant-based production technology in exchange for an upfront payment of \$1,500,000 and a payment of \$500,000 on reaching an important milestone. Under the terms of the Agreement, Medicago will grant the Partner 2,000,000 common share purchase warrants. Each warrant entitles the Partner to acquire one common share of the company for a period of three years following the execution of the Agreement, at an exercise price of 15% over the market price at the time of execution of this Agreement, during the first year, increased by 10% for each of the two subsequent years.

H5N1 Avian influenza VLP vaccine

In 2007 Medicago made a significant breakthrough by using its proprietary expression system to produce a vaccine candidate for H5N1 Avian Influenza in highly immunogenic particles called Virus-Like Particles ("VLPs"). VLPs have significant advantages over conventional vaccines as they are known to enhance immunity and therefore increase protection against disease. These particles are similar to the virus from which they were derived, however they lack viral nucleic acid, which results in the best compromise between safety (not infectious) and efficacy (highly immunogenic).

In October 2007, first positive preclinical results were announced showing that Medicago's Influenza VLP vaccine triggered a strong protective immune response against the lethal H5N1 Indonesia strain currently in circulation. These results demonstrated Medicago's Influenza VLP vaccine can provide a protective antibody response at doses as low as 1 µg. Further testing has now demonstrated that we protect up to 100% of mice in a lethal challenge with various deadly H5N1 viruses. From these results, Medicago has established that its candidate vaccine has the potential to protect against three of the deadliest strains of Pandemic H5N1 Influenza viruses circulating today.

Financing

In May 2007, Medicago announced the successful completion of a private placement of 4,000,000 units at a price of \$0.50 per unit for gross proceeds to Medicago of \$2,000,000, each unit consisting of one common share of Medicago and one common share purchase warrant expiring in two years.

Revenues and Expenses

Revenues are generated from licenses as well as contract research and related milestone payments.

Research and development expenses consist primarily of personnel and related costs associated with research activities for development of the Company's portfolio of product candidates.

General and administrative, business development and intellectual property costs consist of personnel and related costs associated with the Company's functions as well as professional fees, office rent, utilities, insurance and other corporate expenses. It also includes intellectual property-related costs associated with the development and maintenance of the Company's intellectual property portfolio.

Consolidated Statements of Earnings
(In thousands of dollars, except per share amounts)

<i>Financial Results</i>	Year 2007 <i>audited</i>	Quarters ended			
		December 31, 2007	September 30, 2007	June 30, 2007	March 31, 2007
		unaudited	unaudited	unaudited	unaudited
Revenues	\$ 74,1	\$ 55,6	\$ -	\$ -	\$ 18,5
Expenses	\$ (6 347,3)	\$ (2 109,2)	\$ (1 022,8)	\$ (1 550,2)	\$ (1 665,1)
Loss	\$ (6 273,2)	\$ (2 053,6)	\$ (1 022,8)	\$ (1 550,2)	\$ (1 646,6)
Basic and diluted loss per share	\$ (0,32)	\$ (0,07)	\$ (0,06)	\$ (0,09)	\$ (0,10)

<i>Financial Results</i>	Year 2006 <i>audited</i>	Quarters ended			
		December 31, 2006	September 30, 2006	June 30, 2006	March 31, 2006
		unaudited	unaudited	unaudited	unaudited
Revenues	\$ 156,1	\$ 20,0	\$ 14,1	\$ 77,5	\$ 44,5
Expenses	\$ (7 913,7)	\$ (2 293,9)	\$ (1 798,4)	\$ (1 793,9)	\$ (2 027,5)
Loss	\$ (7 757,6)	\$ (2 273,9)	\$ (1 784,3)	\$ (1 716,4)	\$ (1 983,0)
Basic and diluted loss per share	\$ (0,68)	\$ (0,09)	\$ (0,16)	\$ (0,20)	\$ (0,23)

Comparison of the year 2007 and 2006

Revenues

Revenues from research agreements in 2007 were \$74,000, down from \$156,000 in 2006. Work is progressing in 2008-2009 on our pandemic and seasonal vaccines which will lead to our first IND and phase I clinical trial in 2009 on our H5N1 vaccine. Please refer to the "Outlook for 2008-2009" in this report for further details.

Expenses

Research and development expenses totaled \$3,041,000 in 2007, a reduction of \$1,228,000 from \$4,269,000 in 2006. The decrease in research and development expenses in the year 2007 is mainly the result of a reduction of more than \$500,000 in salaries, of which \$288,000 was due to maternity leave. Moreover, Medicago spent \$164,000 less on outsourced contract work in 2007 compared to 2006. Research and development expenses were consistently lower in 2007 compared to 2006, as a result of the Company's focus with its new pandemic Influenza vaccine.

Research grants and contribution decreased by \$69,000 to \$4,000 for the year 2007 compared to 2006. During the year, this amount increased due to the proceeds of a non-bearing interest loan (TPC) in the year 2006 from the implementation in 2007 of new accounting standards with the financial instruments described in note 3 of the financial statements. At year-end, \$393,000 of grants were reclassified as a reduction of other net financial expenses to respect the substance of this item.

Research and development tax credits were at \$931,000 for the year 2007, \$29,000 higher than the year 2006. After its initial public offering in August 2006, Medicago was not able to claim the federal 35% investment tax credit. The Company completed a corporate reorganization in April 2007 that resulted in the creation of new entities to perform all of its research and development activities and therefore maximizing its federal investment tax credits. Moreover, the Company has amended its 2006 provincial tax returns during the quarter claiming an additional \$176,000 credits. The calculations of investment tax credits contain a reserve concerning the perceived risks associated to these credits. Lower research and development expenses in the year 2007 have reduced the absolute amounts of allowable research and development expenses claimed for investment tax credits but the tax reorganization has increased the combined rate from April 1 2007.

General and administrative expenses decreased by \$265,000, or 10%, to \$2,429,000 in 2007 from \$2,694,000 in 2006. The main variations in general and administrative expenses in year 2007 compared to the 2006 are a decrease of \$295,000 in salaries. This decrease in salaries was due to the replacement of the chief financial officer by a consultant and two employees that left the Company during the year without being replaced. Moreover, the Company has reduced its travel and entertainment expenses by \$66,000 in 2007 compared to 2006 given the controls applied throughout the Company.

Depreciation of property, plant and equipment amounted to \$567,000 for the year 2007, \$54,000 lower than the same period in 2006. The variation is due to the declining balance depreciation method.

Amortization of intangible assets stood at \$125,000 during the year 2007, \$8,000 lower than the same period in 2006. The variation is due to the straight-line amortization method.

Other net financial expenses amounted to \$1,088,000 for the year 2007, \$69,000 lower and comparable to the same period in 2006. Although interest rates have increased on the long-term Bio-Levier debt resulting in an increase of \$276,000, at years-end, however, \$393,000 of research grants and contribution have been reclassified to other net financial expenses to respect the substance of this element. A total of \$1,275,000 of interests on the Bio-Levier debt were capitalized to the principal during the year 2007 (\$1,052,000 in 2006).

Consolidated loss for the year 2007 was \$6,273,000, or \$0.32 per basic and diluted share compared to a loss of respectively \$7,758,000, or \$0.68 per basic and diluted share in 2006.

Comparison of the quarter ended December 31, 2007 and 2006

Revenues

Revenues from research agreements in 2007 were \$74,000 down from \$156,000 in 2006. Work is progressing in 2008-2009 on our pandemic and seasonal vaccines which will lead to our first IND and phase 1 in 2009 on our H5N1 vaccine. Please refer to the "Outlook for 2008-2009" in this report for further details.

Expenses

Research and development expenses decreased by \$177,000 to \$844,000 in the fourth quarter of 2007 compared to 2006. The decrease in research and development expenses in the last quarter of 2007 is mainly the result of a reduction of \$74,000 in salaries, compared to the last quarter of 2006. Research and development expenses were consistently lower in 2007 compared to 2006, resulting from the Company's tight focus on its new pandemic Influenza vaccine.

Research and development tax credits were at \$77,000 for the three-month period ended December 31, 2007, \$29,000 higher than the three-month period ended December 31, 2006. The Company completed a corporate reorganization on April 1 2007 resulting in the creation of new entities to perform all of its research and development activities and thus maximizing its federal investment tax credits. The calculations of investment tax credits contain a reserve concerning the perceived risks associated to these credits. Lower research and development expenses in the year 2007 have reduced the absolute amounts of allowable research and development expenses claimed for investment tax credits but the tax reorganization has increased the combined the rate from April 1 2007.

General and administrative, business development and intellectual property expenses increased by \$10,000 to \$808,000 for the three-month period ended December 31, 2007 compared to 2006. This variation is minimal compared to the same period in 2006.

Depreciation of property, plant and equipment amounted to \$145,000 for the three-month period ended December 31, 2007, \$18,000 lower than the corresponding period in 2006. The variation is due to the declining balance depreciation method.

Amortization of intangible assets stood at \$31,000 during the three-month period ended December 31, 2007, \$19,000 lower than the corresponding period in 2006. The variation is due to the straight-line amortization method.

Other net financial expenses amounted to \$19,000 for the three-month period ended December 31, 2007, \$287,000 lower compared to the same period in 2006. Although interest rates have increased on the long-term Bio-Levier debt, the Company reclassified at year-end \$393,000 of research grants and contribution to other net financial expenses to respect the substance of this element.

Consolidated loss for the three-month period ended December 31, 2007 was \$2,054,000, or \$0.07 per basic and diluted share compared to a loss of \$2,274,000, or \$0.09 in 2006.

Generally, our quarterly losses decreased during 2007 because of tight controls on expenses. The main reduction occurred in research and development activities as a result of the Company's tight focus on targeted and promising research and development projects, principally with its new pandemic Influenza vaccine program.

Financial position
(In thousands of dollars)

<i>Balance Sheet</i>	As of December 31 2007 audited	As of December 31 2006 audited
Curent assets	\$ 1 311,6	\$ 2 622,8
Property, plant and equipment	\$ 4 060,9	\$ 4 536,6
Curent liabilities	\$ 2 041,3	\$ 1 303,4
Long-term debt	\$ 14 451,1	\$ 14 005,3
Shareholder's deficiency	\$ (9 830,9)	\$ (5 757,6)

The Company had cash and cash equivalents and short-term deposits totaling \$224,000 on December 31, 2007, a decrease of \$1.4 million from December 31, 2006. The Company had a negative working capital of \$0.7 million as at December 31, 2007, a decrease of \$2 million compared to 2006.

Total consolidated assets were \$6.7 million as of December 31, 2007, a decrease of \$2.9 million from \$9.6 million as of December 31, 2006. The variation is mainly due to a decrease of \$1.4 million in the total of cash and cash equivalents and short-term deposits.

The Company's primary capital needs are the funds required to support its scientific research and development activities including preclinical and clinical trials and capital expenditures for development of its pilot plant facilities as well as working capital. Since its inception, the Company has financed its cash requirements primarily through issuances of securities, investment tax credits, government funding, cost recoveries, contract research revenues, long-term debt and short-term debt guaranteed by its investment tax credits.

Work is progressing in 2008-2009 on our pandemic and seasonal vaccines which will lead to our first IND and phase 1 in 2009 on our H5N1 vaccine. These steps will require important funds. Medicago is working on closing additional financings in 2008. Please refer to the "Outlook for 2008-2009" in this report for further details.

The Company believes that, with the financial resources currently at its disposal, it needs to raise additional funds to be able to continue operations. The Company is in the process of seeking investment in both equity and debt.

The Company's ability to continue as a going concern is contingent upon its ability to obtain additional financing. The Company seeks additional forms of debt or equity financing, but cannot provide assurance that it will be successful in doing so. See 'Risk Factors' of this report.

The investment activities are subject to the guidelines contained in the Company's investment policy. The Company invests only in liquid, high grade investment securities of reputable banks.

Long-term debt

At December 31, 2007, the Company's long-term debt amounted to \$14.5 million, an increase of \$0.5 million from the balance of \$14 million as of December 31, 2006. Under the terms of the Bio-Levier loan agreement, the Company needs to maintain its current ratio of 1.3/1 or higher. As at December 31, 2007, this ratio stood at 0.6/1 (2.0/1 as at December 31, 2006). However, Medicago obtained a waiver from Investissement Québec in that regard.

As a result of the application of the new accounting standards, the opening balance of those debts have been decreased by \$271,368 considering an effective interest rate of 20%. Additional non interest-bearing debts were contracted in fiscal year 2007. Since these debts are non-interest bearing, they have been decreased by \$392,582 and reflected in earnings as grants so as to consider an effective interest rate of 20%.

Cash flow
(In thousands of dollars)

Audited	Periods ending December 31, 2007		Periods ending December 31, 2006	
	Year 2007	Q4	Year 2006	Q4
	Audited	Unaudited	Audited	Unaudited
Operating activities	\$ (4 154,2)	\$ (947,0)	\$ (4 261,9)	\$ (472,0)
Financing activities	\$ 2 810,7	\$ 1 037,4	\$ 3 933,2	\$ 233,5
Investing activities	\$ 1 124,4	\$ 6,4	\$ 582,5	\$ 984,5
Net change in cash	\$ (219,1)	\$ 96,8	\$ 253,8	\$ 746,0

Operating Activities

Cash used in operating activities decreased by \$0.1 million during the year ended December 31, 2007 compared to the same period in 2006. This reduction is mainly the result of the decrease of \$1.5 million in the loss for that year; this is however almost all compensated by the changes in non-cash working capital items which required \$1.3 million less cash during the period compared to the same period in 2006.

Financing Activities

Cash from financing activities decreased by \$1.1 million to \$2.8 million during the year 2007. Although the Company raised \$2.0 million in equity in May 2007, it contracted \$2,9 million of long-term debt in the year ended December 31, 2006 compared to \$0.6 million in 2007.

Investing Activities

Cash used in investing activities, excluding the term deposit, has been minimal during 2007.

Use of proceeds of the IPO

The following table provides information concerning the use of proceeds resulting from the Company's initial public offering pursuant to a final prospectus dated July 31, 2006.

Use of Proceeds	Per prospectus	From September 1, 2006 through December 31, 2007
Development of the Company's endogenous molecule of alfalfa and aprotinin product candidates, including preclinical trials	\$250 000	\$250 000
Investment in business development activities to secure partnership and alliances	\$1 000 000	\$1 000 000
General corporate purposes	\$111 000	\$111 000
Total :	\$1 360 000	\$1 360 000

The Company completed most of the preclinical trials on its endogenous molecule prior to the closing of the IPO and did not start preclinical trials on aprotinin. The Company does not anticipate doing any work on aprotinin as Bayer's Trasylol product is actually under review by the FDA for safety reasons. This money was used in preclinical trials but for an influenza vaccine based on Hemagglutinin (HA).

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, 2007:

	Total	2008	2009	2010	2011	2012	Thereafter
Operating leases	999 405	153 378	203 046	152 286	203 046	203 046	84 603
Licenses	737 000	72 000	102 000	122 000	147 000	147 000	147 000
Long-Term Debt	15 578 816	13 072	173 069	160 000	160 000	160 000	14 912 675

Related Party Transactions and Off-Balance Sheet Agreements

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

Outstanding Share Data

As of April 22, 2008, there were 34,112,440 common shares issued and outstanding, 1,679,808 stock options outstanding, 16,574,530 warrants outstanding and 420,268 options outstanding.

Subsequent Events

On January 28, 2008, the Company collected the second tranche of \$150,000 for a total payment of \$500,000 of the collaboration and non-exclusive licensing agreement with an undisclosed Fortune 100 company to develop a product outside of the Company's core development pipeline.

On February 7, 2008, the Company entered into a non-exclusive license agreement for the development and commercialization of the Company's proprietary plant-based production technology in exchange for an upfront payment of \$1,500,000 and a payment of \$500,000 upon attainment of an important milestone. Under the terms of the Agreement, Medicago will grant the Partner 2,000,000 common share purchase warrants. Each warrant entitles the Partner the right to acquire one common share of Medicago for a period of three years following the execution of the Agreement, at an exercise price of 15% over the market price at the time of execution of this Agreement, during the first year, increased by 10% for each of the following two years.

On March 11, 2008, the Company granted 180,000 stock options to employees and directors. The stock options were issued at an exercise price of \$0.66 and expire in five years.

On March 14, 2008, the Company completed a private placement of 13,000,000 units (the "Units") at a price of \$0.20 per Unit for gross proceeds of \$2,6 million, each Unit consisting of one common share of Medicago and one-half common share purchase warrant. Each share purchase warrant entitles the holder thereof to purchase one common share at a price of \$0.25 until March 14, 2010. The Company paid a cash finder's fee of 6% in connection with this placement.

On March 26, 2008, the Company amended the terms of its loan from Investissement Québec whereby only 50% of the interests of the year 2008 will be capitalized to the loan in exchange for the issuance of 643,877 warrants expiring in three years with an exercise price corresponding to the weighted average of the last five days preceding the issue request to TSX Venture. This agreement is subject to the TSX Venture's acceptance.

On March 31, 2008, the Company granted 83,850 stock options to an officer and director. The stock options were issued at an exercise price of \$0.62 and expire in five years.

Outlook for 2008-2009

Medicago continues to work towards the development of its H5N1 vaccine in 2008 as well as to begin the development of its annual influenza vaccine. The Company expects the following milestones to be completed in 2008 and 2009:

H5N1 pandemic vaccine:

- Immunogenicity and lethal challenge study in ferrets;
- Pre-IND meeting with regulatory authorities;
- Toxicology study;
- IND filing and initialization of Phase I studies;
- Completion of phase I study;

Seasonal vaccine:

- Production of a trivalent VLP based seasonal vaccine;
- Initial immunogenicity studies;
- Pre-IND meeting with regulatory authorities.

Partnerships:

- Ongoing discussion with potential and existing partners.

Financing:

- In order to attain these milestones, additional sources of financing will be completed in 2008.

Critical Accounting Policies and Estimates

Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities reported in the financial statements. These 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. Actual results could differ from those estimates.

The Company is entitled to tax credits on scientific research and experimental development expenditures. These tax credits and grants are recorded when there is a reasonable assurance of their recovery using the costs reduction method.

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 over its fair value.

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, 2007 and 2006, no development costs have been capitalized.

Research and Development Tax Credits and Grants

The Company is entitled to scientific research and experimental development tax credits granted by the Canadian federal government and the government of the Province of Québec. These 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 period the expenses are incurred.

During and following the taxation year during which the Offering is completed, federal tax credits related to scientific research and experimental development expenditures incurred thereafter would no longer be refundable and may only be used by the Company to reduce future income taxes payable, if any. The Company completed on April 1 2007 a corporate reorganization resulting in the creation of new entities to perform all of its research and development activities and thus maximizing its federal credit rates related to scientific research and experimental development expenditures.

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 over the term of the agreement.

Development agreements are at fixed prices and cost overruns are assumed by the Company.

New Accounting Standards

On January 1, 2007, the company adopted prospectively the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"):

- Section 1506, "Accounting Changes." This section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.
- Section 1530, "Comprehensive Income." This section establishes standards for reporting and display of certain gains and losses recognized in comprehensive income, but excluded from net income.
- Section 3251, "Equity". This section establishes standards for the presentation of equity and changes in equity. The requirements of this section are in addition to those in "Comprehensive Income", Section 1530, "Share capital", Section 3240, and "Reserves", Section 3260.
- Section 3855 "Financial Instruments – Recognition and Measurement". This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the consolidated financial statements. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, whether they are part of a hedging relationship or not, have to be measured at fair value. The company does not use hedge accounting.
- Section 3865, "Hedges." This section provides an alternative to Section 3855 for entities that choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline AcG-13, "Hedging Relationships," and on the hedging guidance in Section 1650, "Foreign Currency Translation."

As a result of the adoption of these standards, the company has made the following classifications:

Cash and cash equivalents	Held for trading
Other receivables	Loans and receivables
Financing receivable	Loans and receivables
Bank loans	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities

Financial and Other Instruments

Fair Value

The Company's financial instruments recognized in the balance sheet consist of cash and cash equivalents, accounts receivable, financing receivable, grants receivable, bank loans, accounts payable and accrued liabilities and long-term debt. The fair values of these financial instruments approximate their carrying value due to their short-term maturity or to current market rates. The fair value of the long-term debt approximates its carrying value due to the use of the effective interest rate method.

Credit Risk

Financial instruments which potentially subject the Company to credit risk consist principally of cash and cash equivalents. The Company's cash and cash equivalents are held with or issued by high-credit quality financial institutions; therefore the company considers the risk of non-performance on these instruments to be remote.

Currency Risk

Certain Company's operations are denominated in euros. Accordingly, certain items recorded in the balance sheet or in the statement of earnings are exposed to currency fluctuations. The Company has no forward exchange contract as of December 31, 2007.

Risk factors and Uncertainties

Early Stage Development

Medicago is still at an early stage of development, having commenced its operations in 1999, and still has a short operating history. The Company's product candidates or third-party products will require additional 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 preclinical development, the Company still has not demonstrated efficacy in humans for any of the Company's plant produced proteins or received any regulatory authorization for clinical trials. It is not known whether the Company will meet applicable health regulatory standards and obtain the required regulatory approvals for its current products or product candidates.

Currently, the Company's ability to produce a commercial quantity of its products and product candidates has not been proven 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.

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, 2007 of \$36,271,760. Losses are expected to 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.

Regulation of Drug and Product Approval

Potential investors 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.

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 IND 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.

Regulation of Genetically Engineered Plants

The Company must comply with regulations of the USDA, 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 labeling 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.

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.

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.

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. 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 biotechnology companies, or financing from other sources may be undertaken. There can be no assurance that additional funding will be available on terms which are acceptable to the Company and which would result in successful commercialization of its products and product candidates. If adequate funding is not available, the Company may be required to delay, reduce, or eliminate one or more of its product development programs or obtain funds through corporate partners or others who may require the Company to relinquish significant rights to protect candidates or obtain funds on less favorable terms than the Company would otherwise accept.

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.

Cost Overruns

As a contract manufacturer organization, the Company has entered and will enter into agreements where it has agreed to execute specific obligations for a fixed price. The Company's failure to successfully execute its obligations without incurring cost overruns, for which the Company is liable, would have a material adverse effect on its business, financial condition and results of operations.

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 favorable 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.

Establishment of Internal Drug Development Capabilities

The drug development process is inherently complex. The preparation of cGMP quality material for clinical trials, the design and implementation of those trials and the reporting of those results to the FDA and other agencies require a high level of expertise and experience from the Company if this process is to be successful. The Company does not have personnel within its organization who have such experience, nor is there any assurance that the Company will be able to recruit such people as employees. Failure to do so could lead to delays in the implementation and completion of clinical trials, or even lead to clinical failure due to poor clinical design or execution.

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. There can be no assurance, however, that the Company will be able to establish such additional collaborations on favorable 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 current 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 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 provincial and federal investment tax credits on expenditures incurred on scientific research and experimental development. There is a risk that the governmental agency could conclude that some or all of the expenditures were not incurred on scientific research and experimental development activities and, therefore, could reduce or disallow claims for such credits, including refundable credits.

Management of Growth

Recent rapid growth in all areas of the Company's business has placed, and is expected to continue to 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.

Continuous Disclosure and Disclosure Controls

The Company is a reporting issuer under the securities legislation of many provinces of Canada and it is, therefore, required to file continuous disclosure documents such as interim and annual financial statements, a proxy circular, an annual information form, material change reports and press releases with such securities regulatory authorities. Copies of these documents may be obtained free of charge on request from the office of the Secretary of the Company or through the Internet at the following addresses: www.sedar.com.

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures of the Company. These disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports filed with securities regulatory authorities is recorded and/or disclosed on a timely basis, as required by law, and is accumulated and communicated to the Company's management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2007. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in all material respects as of December 31, 2007, to ensure that material information relating to the Company and its subsidiaries would have been made known to them.

Internal Controls over Financial Reporting

Internal control over financial reporting ("ICFR") is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and its compliance with GAAP in its financial statements. The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining internal controls over financial reporting to the issuers. They established or made establish under their supervision the internal control over the financial reporting to obtain reasonable insurance about the financial reporting effectiveness and that the financial statements were being prepared accordingly with GAAP.

The Chief Executive Officer and the Chief Financial Officer have evaluated whether there were changes to its ICFR during the year ended December 31, 2007 that have materially affected, or that are reasonably likely to materially affect its ICFR. No such changes were identified through their evaluation.

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 April 22, 2008, date of the Board's approval for the MD&A and the Consolidated Financial Statements. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law.

On behalf of management,

(signed)
Vincent Bélanger, CA
Chief Financial Officer

April 22, 2008

MANAGEMENT REPORT

The following consolidated financial statements of Medicago Inc. and all other financial information contained in this annual report are the responsibility of management. Management has prepared the consolidated financial statements in accordance with Canadian generally accepted accounting principles. When it was possible to choose different accounting methods, management chose those that it felt were the most appropriate in the circumstances.

The financial statements include amounts based on the use of estimates and best judgment. Management has determined these amounts in a reasonable way in order to ensure that the financial statements are presented accurately in all important regards. Management has also prepared the financial information presented elsewhere in the annual report, and has ensured that it is in accordance with the financial statements.

Management maintains systems of internal accounting and administrative controls. The systems are used to provide a reasonable degree of certainty that the financial information is relevant, reliable and accurate, and that the Company's assets are correctly accounted for and effectively protected.

The Board of Directors is responsible for ensuring that management assumes its responsibilities with regard to the presentation of financial information, and has ultimate responsibility for examining and approving the financial statements. The Board assumes this responsibility principally through its Audit Committee which is comprised of outside and non-management directors. The Audit Committee met with management as well as with external auditors to discuss the internal monitoring system for presenting financial information, to address issues related to the audit and the presentation of financial information, to ensure that all parties carry out their duties correctly, and to examine the financial statements and the report of the external auditors.

The consolidated financial statements have been audited on behalf of shareholders by external auditors PricewaterhouseCoopers LLP/s.r.l./s.e.n.c. for each of the years ended December 31, 2007 and 2006, in accordance with Canadian generally accepted accounting principles. The external auditors, having been appointed by the shareholders to serve as the Company's external auditors, were given full and unrestricted access to the Audit Committee to discuss matters related to their audit and the reporting of information.

The Board of Directors has approved the Company's consolidated financial statements on the recommendation of the Audit Committee.

(s) Andrew J. Sheldon

Andrew J. Sheldon
President and Chief Executive Officer

(s) Vincent Bélanger

Vincent Bélanger, CA
Chief Financial Officer

Quebec City, Quebec, Canada
April 22, 2008

Medicago Inc.

Consolidated Financial Statements
December 31, 2007 and 2006

Auditors' Report

To the Shareholders of Medicago Inc.

We have audited the consolidated balance sheets of **Medicago Inc.** as at December 31, 2007 and 2006 and the consolidated statements of earnings and comprehensive loss, deficit 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, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Québec, Quebec, Canada
April 22, 2008

Medicago Inc.

Consolidated Balance Sheets

As at December 31,

	2007 \$	2006 \$
Assets		
Current assets		
Cash and cash equivalents	223,711	442,929
Term deposit	-	1,230,188
Current portion of security deposit on a lease agreement	-	20,000
Accounts receivable (note 5)	69,745	79,130
Financing receivable (note 11b)	71,641	171,926
Investment tax credits receivable (note 9)	844,245	581,167
Grants receivable	9,308	23,125
Prepaid expenses	92,963	74,312
	<u>1,311,613</u>	<u>2,622,777</u>
Security deposit on a lease agreement	-	20,000
Property, plant and equipment (notes 6 and 11)	4,060,918	4,536,560
Intangible assets (note 7)	1,289,052	1,433,552
Deferred financing expenses (notes 8 and 11)	-	938,189
	<u>6,661,583</u>	<u>9,551,078</u>
Liabilities		
Current liabilities		
Bank loans (note 9)	750,000	300,000
Accounts payable and accrued liabilities (note 10)	983,849	990,338
Deferred revenues on research agreements	294,400	-
Current portion of long-term debt	13,072	13,072
	<u>2,041,321</u>	<u>1,303,410</u>
Long-term debt (note 11)	14,451,147	14,005,310
Retractable shares (note 12)	-	-
	<u>16,492,468</u>	<u>15,308,720</u>
Shareholders' Deficiency		
Share capital (note 13)	23,465,147	22,152,413
Contributed surplus (note 14a)	802,219	798,034
Other equity components (note 14)		
Stock options (note 14a)	263,821	110,926
Unit options (note 14b)	122,135	55,495
Warrants (note 14c)	1,787,553	1,395,437
Deficit	<u>(36,271,760)</u>	<u>(30,269,947)</u>
	<u>(9,830,885)</u>	<u>(5,757,642)</u>
	<u>6,661,583</u>	<u>9,551,078</u>
Going concern (note 1)		
Commitments (note 18)		
Subsequent events (note 21)		

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

Approved by the Board of Directors

(2)

(signed) RANDAL CHASE, PH.D. _____ Director

(signed) ANDREW J. SHELDON _____ Director

Medicago Inc.

Consolidated Statements of Deficit For the years ended December 31,

	2007 \$	2006 \$
Balance – Beginning of year	30,269,947	22,512,316
Adjustment related to the implementation of the new accounting standard on financial instruments (note 3)	(271,368)	-
Loss for the year	6,273,181	7,757,631
Balance – End of year	<u>36,271,760</u>	<u>30,269,947</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,

	2007 \$	2006 \$
Revenues from research agreements	74,100	156,087
Expenses		
Research and development	3,040,750	4,269,184
Research grants and contributions	(4,375)	(72,544)
Research and development tax credits	(930,876)	(901,715)
General and administrative	2,429,281	2,693,751
Exchange loss (gain)	(3,310)	14,067
Depreciation of property, plant and equipment	567,478	620,792
Amortization of intangible assets	125,307	132,760
Gain on disposal of property, plant and equipment	(14,135)	-
Writeoff of intangible assets	48,838	-
Financial expenses, net (note 15)	1,088,323	1,157,423
	6,347,281	7,913,718
Loss and comprehensive loss for the year	(6,273,181)	(7,757,631)
Basic and diluted loss per share (note 20)	(0.32)	(0.68)
Going concern (note 1)		

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,

	2007 \$	2006 \$
Cash flows from operating activities		
Loss for the year	(6,273,181)	(7,757,631)
Items not affecting cash and cash equivalents		
Stock-based compensation costs	157,080	57,239
Depreciation and amortization	810,283	895,141
Gain on disposal of property, plant and equipment	(14,135)	-
Interest capitalized on long-term debt	1,341,309	1,052,105
Writeoff of intangible assets	48,838	-
Grants (note 11d)	(392,582)	-
	(4,322,388)	(5,753,146)
Change in non-cash working capital items (note 16a)	168,141	1,491,295
	(4,154,247)	(4,261,851)
Cash flows from financing activities		
Bank loans contracted (reimbursed)	450,000	(177,606)
Non-interest-bearing long-term debt contracted	602,241	457,925
Long-term debt contracted	-	2,447,929
Payments on long-term debt	(13,072)	(13,072)
Issuance of units	2,000,000	2,003,834
Issue expenses	(228,510)	(785,801)
	2,810,659	3,933,209
Cash flows from investing activities		
Term deposit cashed	1,230,188	969,812
Decrease in security deposit on a lease agreement	40,000	20,000
Additions to property, plant and equipment	(102,893)	(281,369)
Proceeds from disposal of property, plant and equipment	18,500	-
Additions to intangible assets	(61,425)	(125,993)
	1,124,370	582,450
Net change in cash and cash equivalents	(219,218)	253,808
Cash and cash equivalents – Beginning of year	442,929	189,121
Cash and cash equivalents – End of year	223,711	442,929
Additional information (note 16b)		
Interest paid	87,438	40,440

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

(5)

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2007 and 2006

1 Going concern

While the accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, certain adverse conditions and events cast substantial doubt upon the validity of this assumption. The company has not yet realized profitable operations and has relied mostly on non-operational sources of financing to fund operations. The company's ability to continue as a going concern will be dependent on management's ability to successfully execute its business plan, which includes an increase in revenue and product development. The company seeks additional forms of debt or equity financing, but cannot provide assurance that it will be successful in doing so. These financial statements do not include adjustments or disclosures that may result from the company's inability to continue as a going concern. If the going concern assumption is not appropriate for these financial statements, then adjustments would be necessary in the carrying value of assets and liabilities and the reported losses and balance sheet classifications used.

The company's current strategy is to increase its revenues from existing products by entering into additional product development agreements. Medicago will generate revenues through timely delivery of clinical quantities, milestone payments on successful completion of clinical studies and royalties from product sales or from product development agreements.

Notwithstanding note 21, management believes that additional equity or debt-based financing will be required to continue the company's operations. Furthermore, in management's opinion, the company's continued existence is dependent on the latter's ability to increase revenue from existing products through product development with selected partners. There is no assurance that management will be successful in these actions.

2 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, production and commercialization of vaccines using its unique and proprietary manufacturing systems.

3 Changes in accounting policies

On January 1, 2007, the company adopted prospectively the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"):

- Section 1506, "Accounting Changes." This section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.
- Section 1530, "Comprehensive Income." This section establishes standards for reporting and display of certain gains and losses recognized in comprehensive income, but excluded from net income.

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- Section 3251, "Equity". This section establishes standards for the presentation of equity and changes in equity. The requirements of this section are in addition to those in "Comprehensive Income", Section 1530, "Share capital", Section 3240, and "Reserves", Section 3260.
- Section 3855 "Financial Instruments – Recognition and Measurement". This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the consolidated financial statements. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, whether they are part of a hedging relationship or not, have to be measured at fair value. The company does not use hedge accounting.
- Section 3865, "Hedges." This section provides an alternative to Section 3855 for entities that choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline AcG-13, "Hedging Relationships," and on the hedging guidance in Section 1650, "Foreign Currency Translation."

As a result of the adoption of these standards, the company has made the following classifications:

Cash and cash equivalents	Held for trading
Other receivables	Loans and receivables
Financing receivable	Loans and receivables
Bank loans	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities

Financial assets and liabilities

In accordance with the new standards, 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. Unless in the presence of specific circumstances, the classification is not modified following the initial recognition.

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.

Held-to-maturity investments, loans and receivables and other financial liabilities

Financial instruments classified as held-to-maturity investments, 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.

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Available-for-sale assets

Financial instruments classified as available for sale are recorded at fair value, and the gains/losses resulting from the revaluation at the end of each period are recognized as comprehensive income. Securities classified as 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.

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. Consequently, deferred financing expenses have been reclassified and applied against the related debts.

Recognition of financial assets and liabilities

Effective interest rate method

Premiums and discounts on short-term investments and long-term debt are accounted for using the effective interest rate method.

The impact of the use of the effective interest rate method on long-term debt is recognized as an adjustment to the opening balance of deficit.

Here is a summary of the impact of these new accounting standards on the 2007 opening balances.

	December 31, 2006	Adjustments	January 1, 2007
	\$	\$	\$
Assets			
Deferred financing expenses (note 8)	938,189	(938,189)	-
Liabilities and Shareholders' Deficiency			
Long-term debt	14,005,310	(1,209,557)	12,795,753
Deficit	(30,269,947)	271,368	(29,998,579)

Medicago Inc.

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Future accounting changes

The CICA published the following new sections that will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008, except for Section 3064:

- Section 3862, "Financial Instruments – Disclosures". This section describes the required disclosures to evaluate the significance of financial instruments for the entity's financial position and performance as well as the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks.
- Section 3863, "Financial Instruments – Presentation". This section establishes standards for presentation of financial instruments and non-financial derivatives. It details the presentation of standards described in Section 3861, "Financial Instruments – Disclosure and Presentation".
- Section 1535, "Capital Disclosures". This section establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure of the entity's objectives, policies and processes for managing capital as well as summary quantitative data on the elements included in the management of capital. The section seeks to determine if the entity has complied with capital requirements and if not, the consequences of such non-compliance.
- Section 3031, "Inventories". This section prescribes the accounting treatment for inventories. It provides guidance on the determination of cost and its subsequent recognition as an expense, including any writedown to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

The CICA amended Section 1400, "General Standards of Financial Statement Presentation" to include requirements to assess and disclose an entity's ability to continue as a going concern (going concern assumption).

Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". The new sections will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the company will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062.

The company is currently evaluating the impact of the adoption of these new sections on its consolidated financial statements.

Medicago Inc.

Notes to Consolidated Financial Statements December 31, 2007 and 2006

4 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., 9177-4299 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. 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, the 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.

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.

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.

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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%.

Deferred financing expenses

For 2006, deferred financing expenses were amortized using the straight-line method over the term of the related financing (note 3).

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. During fiscal years 2007 and 2006, no impairment loss has been recognized.

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.

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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, 2007 and 2006, 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.

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 over the term of the agreement.

Development agreements are at fixed price and cost overruns are assumed by the company.

Stock-based compensation and other stock-based payments

The company has a stock option plan which is described in note 14. The company used the minimum value for stock options granted to employees between January 1, 2003 and December 31, 2006. 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.

Basic and diluted earnings per share

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

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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.

5 Accounts receivable

	2007 \$	2006 \$
Commodity taxes receivable	51,694	64,112
Other receivables	18,051	15,018
	<u>69,745</u>	<u>79,130</u>

6 Property, plant and equipment

	2007		2006	
	Cost \$	Accumulated depreciation \$	Cost \$	Accumulated depreciation \$
Land	276,612	-	276,612	-
Production unit	3,490,335	478,530	3,490,335	303,014
Leasehold improvements	302,506	266,566	293,756	166,067
Computer equipment	363,469	291,472	363,469	260,595
Laboratory equipment	2,064,024	1,413,794	2,022,793	1,192,196
Office furniture	165,800	115,651	165,800	103,360
	6,662,746	2,566,013	6,612,765	2,025,232
Research and development tax credits	(227,512)	(191,697)	(227,512)	(176,539)
	6,435,234	<u>2,374,316</u>	6,385,253	<u>1,848,693</u>
Less: Accumulated depreciation	<u>2,374,316</u>		<u>1,848,693</u>	
Net amount	<u>4,060,918</u>		<u>4,536,560</u>	

Medicago Inc.

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7 Intangible assets

	2007		2006	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
License	1,136,982	460,501	1,138,996	405,675
Patents	804,728	205,452	829,434	166,082
Software	57,660	44,365	225,370	187,177
	1,999,370	710,318	2,193,800	758,934
Research and development tax credits	(15,106)	(15,106)	(15,106)	(13,792)
	1,984,264	<u>695,212</u>	2,178,694	<u>745,142</u>
Less: Accumulated amortization	<u>695,212</u>		<u>745,142</u>	
Net amount	<u>1,289,052</u>		<u>1,433,552</u>	

8 Deferred financing expenses

	Amortization period (years)	2007		2006	
		Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Financing expenses related to the loan from Investissement Québec	10	-	<u>-</u>	1,174,995	<u>236,806</u>
Less: Accumulated amortization		<u>-</u>		<u>236,806</u>	
Net amount (note 3)		<u>-</u>		<u>938,189</u>	

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9 Bank loans

	2007 \$	2006 \$
Bearing interest at prime rate plus 1.75% annually, repayable at the earlier through the investment tax credits receivable, maturing in June 30, 2009 *	250,000	-
Bearing interest at 18% annually, repayable at the earlier of the following: upon receipt of tax credits or on September 18, 2008 *	300,000	-
Bearing interest at prime rate plus 3.5% annually, repayable at the earlier of the following: upon receipt of tax credits or on June 30, 2009 *	200,000	-
Reimbursed during the year	-	300,000
	<hr/> 750,000	<hr/> 300,000

* Investments tax credits have been given as security for those bank loans.

10 Accounts payable and accrued liabilities

	2007 \$	2006 \$
Accounts payable	624,594	452,577
Salaries and fringe benefits	210,802	289,826
Accrued liabilities	148,453	206,076
Balance of purchase price of property, plant and equipment	-	41,859
	<hr/> 983,849	<hr/> 990,338

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11 Long-term debt

	2007	2006
	\$	\$
Loan from Investissement Québec ("IQ"), bearing interest at prime rate plus 3%, payable annually from December 2007 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 (note 21) (a)	14,717,187	13,441,580
Contribution under an innovation program, payable in semiannual instalments of \$6,536 since April 2005, non-interest bearing (d)	21,653	39,213
Refundable contribution granted under the Technology Partnerships Canada program, non-interest bearing (b), (d)	384,618	395,300
Contribution under an innovation program, payable in annual instalments of \$28,458 from January 2007, non-interest bearing (c), (d)	161,452	142,289
Deferred financing expenses (note 3)	(820,691)	-
	<u>14,464,219</u>	<u>14,018,382</u>
Less: Current portion	<u>13,072</u>	<u>13,072</u>
	<u>14,451,147</u>	<u>14,005,310</u>

- (a) On July 28, 2003, the company signed a loan agreement of \$12,000,000 with IQ under the Bio-Levier Program. As at December 31, 2007, the company has used \$12,000,000 plus capitalized interest of \$2,717,187.

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

- (i) For the first three years, the company may defer the principal instalments and may capitalize interest. Afterwards, interest is payable on a monthly basis from December 21, 2007.
- (ii) The interest rate may be converted into a fixed rate upon the complete use of the available balance of the loan.
- (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 stock at a price of \$1.12 for a period ending no later than August 30, 2011. Their fair value of \$1,174,995 has been recorded as deferred financing expenses (note 8).

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- (v) Under the terms of the agreement, the company undertook to meet a current ratio exceeding 1.3:1. As at December 31, 2007, the current ratio has not been met. However, the company obtained a waiver from IQ in that regard.
- (b) Under the federal contribution program called Technology Partnerships Canada ("TPC"), the company is entitled to receive a refundable contribution equivalent to 33% of the eligible expenses incurred by the company in the optimization and scale-up of its production unit up to a maximum of \$848,200. Royalties of 2% on gross cash proceeds of any kind will be payable from January 1, 2009 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, 2019; subsequent to this date, no further payments will be required. As at December 31, 2007, an amount of \$71,641 is receivable under this program.
- (c) Under a federal innovation program, the company is entitled to receive a refundable contribution equivalent to 47.1% of the eligible expenses incurred by the company for business development and intellectual property up to a maximum of \$300,000. This contribution is refundable in annual instalments, beginning after a two-year period following the end of the project, which project shall not end later than September 1, 2007. As at December 31, 2007, no amount is receivable under this program.
- (d) As a result of the application of the new accounting standard (see note 3), the opening balance of the non-interest-bearing debts have been decreased by \$271,368 so as to consider an effective interest rate of 20%. Additional non-interest-bearing debts were contracted in fiscal year 2007. Since these debts are non-interest bearing, they have been decreased by \$392,582 and reflected in earnings as grants so as to consider an effective interest rate of 20%.

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

	\$
2008	13,072
2009	173,069
2010	160,000
2011	160,000
2012	160,000

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12 Retractable shares

As part of the initial public offering as described in note 14, retractable shares have been converted into common shares. The corporate reorganization is detailed in note 14.

Retractable shares have varied as follows:

	For the years ended December 31,			
	2007		2006	
	Number	\$	Number	\$
Class A shares				
Balance – Beginning of year	-	-	480,163	809,664
Conversion into common shares			(480,163)	(809,664)
Balance – End of year	-	-	-	-
Class B shares				
Balance – Beginning of year	-	-	5,971,307	10,044,118
Conversion into common shares			(5,971,307)	(10,044,118)
Balance – End of year	-	-	-	-
Total retractable shares	-	-	-	-

13 Share capital

The share capital of the company, which was made up of an unlimited number of Class A, B and C shares, all of them without par value, was modified as follows on July 31, 2006. The effective date of the reorganization was concurrent with the closing of the initial public offering, being August 30, 2006:

- Creation of common shares, without par value, voting and participating;
- Creation of preferred shares, without par value, with rights, privileges and conditions to be determined by the Board of Directors before issuance;
- Three-for-one consolidation of Class A, B and C shares into common shares;
- Cancellation of Class A, B and C shares.

The authorized share capital of the company is now 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

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The share capital issued has varied as follows:

	For the years ended December 31,			
	2007		2006	
	Number	\$	Number	\$
Common shares				
Balance – Beginning of year	17,112,440	22,152,413	-	-
Issued pursuant to a private placement	(i), (ii) 4,000,000	1,540,000	-	-
Issue expenses *	-	(227,266)	-	-
Conversion of Class A shares	-	-	4,870,408	6,186,433
Conversion of Class B shares	-	-	3,785,617	4,309,957
Conversion of Class C shares	-	-	1,111	1,666
Conversion of retractable Class A shares	-	-	480,163	809,664
Conversion of retractable Class B shares	-	-	5,971,307	10,044,118
Retractable share issue expenses	-	-	-	(141,521)
Issued pursuant to the initial public offering	(iii), (vi) -	-	2,003,834	1,623,864
Issue expenses *	-	-	-	(681,768)
Balance – End of year	21,112,440	23,465,147	17,112,440	22,152,413
Class A shares				
Balance – Beginning of year	-	-	4,870,408	6,186,433
Conversion into common shares	-	-	(4,870,408)	(6,186,433)
Balance – End of year	-	-	-	-
Class B shares				
Balance – Beginning of year	-	-	3,785,617	4,309,957
Conversion into common shares	-	-	(3,785,617)	(4,309,957)
Balance – End of year	-	-	-	-
Class C shares				
Balance – Beginning of year	-	-	1,111	1,666
Conversion into common shares	-	-	(1,111)	(1,666)
Balance – End of year	-	-	-	-
Total share capital	21,112,440	23,465,147	17,112,440	22,152,413

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

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- (i) On May 29, 2007, the company issued 4,000,000 units at a price of \$0.50 per unit for total gross proceeds of \$2,000,000 (the "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 \$0.75.
- (ii) The gross proceeds of the Private Placement of \$2,000,000 are shared out between the 4,000,000 common shares for a gross amount of \$1,540,000 and the 4,000,000 warrants attached to each unit for a gross amount of \$460,000 (note 14d). In connection with this financing, the company paid a cash compensation equivalent to 7% of the gross proceeds from the financing, being \$140,000. The company has also granted a non-transferable unit option to the agent entitling to subscribe, before May 29, 2009, for 280,000 options at a price of \$0.50 per share as financing expenses (note 14c). Each option entitles the holder thereof to purchase one common share at a price of \$0.50.
- (iii) On August 30, 2006, the company issued 2,003,834 units at a price of \$1.00 per unit for total gross proceeds of \$2,003,834 pursuant to the initial public offering (the "Offering"). 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 \$1.10.
- (iv) Prior to the closing of the Offering, the shareholders of the company approved a three-for-one consolidation of all the company's common and retractable shares and warrants and the conversion into common shares of all retractable shares. In addition, a similar consolidation was made regarding all outstanding common share options. The share consolidation has been reflected in these financial statements.
- (v) Prior to the closing of the Offering, the company completed a corporate reorganization as follows: each of Dr. Louis-P. Vézina and François Arcand have each sold to a holding company entirely controlled by each of them (respectively, "LPV NewCo" and "FA NewCo") shares that they respectively owned in the share capital of the company, in consideration for shares of those newly created holding companies. Immediately thereafter, Dr. Vézina sold to another wholly-owned holding company, ("LPV HoldCo"), the balance of its shares of Medicago. In consideration for such sale, LPV HoldCo issued, in favour of Dr. Vézina, shares of its share capital. On May 30, 2006, the company, LPV NewCo and FA NewCo have entered into an amalgamation agreement pursuant to which the company, LPV NewCo and FA NewCo have filed articles, as of July 31, 2006, of amalgamation pursuant to Part IA of the Companies Act (Québec) to form a new company named Medicago Inc.
- (vi) The gross proceeds of the Offering of \$2,003,834 are shared out between the 2,003,834 common shares for a gross amount of \$1,623,864 and the 2,003,834 warrants attached to each unit for a gross amount of \$379,970 (note 13d). In connection with this investment, the company paid a cash compensation equivalent to 7% of the gross proceeds from the investment, being \$140,268. The company has also granted a non-transferable unit option to the agent entitling to subscribe, before August 30, 2008, for 140,268 units at a price of \$1.00 per unit as financing expenses (note 14c). 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 \$1.10.

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14 Other equity components

(a) Stock option plan

On April 27, 2006, the Board of Directors of the company adopted amendments to the company's stock option plan (the "Plan"), which entered into effect upon the closing of the company's Offering. All options issued and outstanding under the company's original stock option plan were subject to these amendments to the Plan. Under 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"). The number of common shares reserved under the Plan is fixed at 1,710,000 common shares.

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, 2006:

	For the years ended December 31,					
	2007			2006		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding – Beginning of year	1,628,978	110,926	1.12	708,188	53,687	1.65
Granted	97,000	-	0.91	1,096,400	-	1.04
Exercised	-	-	-	-	-	-
Forfeited	(310,020)	(4,185) *	1.17	(175,610)	-	2.15
Compensation costs for the year	-	157,080	-	-	57,239	-
Outstanding – End of year	1,415,958	263,821	1.10	1,628,978	110,926	1.12
Options exercisable – End of year	751,258	-	1.13	436,657	-	1.17

* During fiscal 2007, 310,020 stock options were forfeited. The corresponding credit amounting to \$4,185 has been recorded as contributed surplus.

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Notes to Consolidated Financial Statements

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The following table summarizes information about outstanding and exercisable stock options as at December 31, 2007:

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 \$
\$0.65	25,000	56	0.65	-	0.65
\$1.00	860,164	43	1.00	288,163	1.00
\$1.11	378,706	33	1.11	378,706	1.11
\$1.50 to \$1.68	152,088	42	1.68	84,389	1.68
	<u>1,415,958</u>	<u>40</u>	<u>1.10</u>	<u>751,258</u>	<u>1.13</u>

Assumptions used in determining stock-based compensation costs

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

	2007	2006
Dividend yield	Nil	Nil
Expected volatility	82.73%	72.11%
Risk-free interest rate	4.12%	4.04%
Expected life (years)	5.00	5.00
Weighted average fair value of stock options granted (\$)	0.58	0.49

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(b) Unit options

The following table summarizes the unit option activity since January 1, 2006 :

	For the years ended December 31,					
	2007			2006		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding and exercisable – Beginning of year	140,268	55,495	1.00	-	-	-
Granted to the agent pursuant to the private placement	280,000	66,640	0.75	140,268	55,495	1.00
Outstanding and exercisable – End of year	420,268	122,135	0.83	140,268	55,495	1.00

The following table summarizes information about unit options outstanding and exercisable as at December 31, 2007:

Exercise price	Number	Weighted average remaining (years)
\$1.00	140,268	0.67
\$0.75	280,000	1.41
	420,268	1.16

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

	2007	2006
Dividend yield	Nil	Nil
Expected volatility	85%	56%
Risk-free interest rate	4.53%	4.02%
Expected life (years)	2	2
Fair value of unit options granted (\$)	0.238	0.40

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(c) Warrants

The following table summarizes the warrants activity since January 1, 2006:

	2007			2006		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding and exercisable – Beginning of year	3,872,321	1,395,437	1.11	1,868,487	1,174,995	1.12
Granted to the subscribers in connection with the first public offering	-	-	-	2,003,834	379,970	1.10
Granted to the subscribers in connection with a private offering	4,000,000	460,000	0.75	-	-	-
Cancelled *	(441,668)	-	-	-	-	-
Warrant issue expenses	-	(67,884)	-	-	(159,528)	-
Outstanding and exercisable – End of year	<u>7,430,653</u>	<u>1,787,553</u>	<u>1.05</u>	<u>3,872,321</u>	<u>1,395,437</u>	<u>1.11</u>

* No carrying value has been allocated to these warrants since they were granted before January 1, 2003.

The following table summarizes the information relating to warrants outstanding and exercisable as at December 31, 2007:

Exercise price	Number	Weighted average remaining (years)
\$0.75	4,000,000	1.41
\$1.10	2,003,834	0.67
\$1.12	1,426,819	3.67
	<u>7,430,653</u>	<u>1.64</u>

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

	2007	2006
Dividend yield	Nil	Nil
Expected volatility	85%	56%
Risk-free interest rate	4.53%	4.02%
Expected life (years)	2	2
Fair value of warrants granted (\$)	0.115	0.189

15 Financial expenses, net

	2007	2006
	\$	\$
Interest on long-term debt	1,341,309	1,064,917
Interest and bank charges	50,786	37,017
Amortization of deferred financing expenses	117,498	141,589
Interest income	(28,688)	(86,100)
Grants (note 11)	(392,582)	-
	<u>1,088,323</u>	<u>1,157,423</u>

16 Additional information on cash flows

(a) Change in non-cash working capital items

	2007	2006
	\$	\$
Accounts receivable, grants and financing receivable	123,487	(70,253)
Investment tax credits receivable	(263,078)	1,505,932
Prepaid expenses	(18,651)	53,495
Accounts payable and accrued liabilities	31,983	23,114
Deferred revenues on research agreements	294,400	(20,993)
	<u>168,141</u>	<u>1,491,295</u>

(b) Other components

During fiscal 2007, the company acquired property, plant and equipment of which an amount of \$3,387 (\$10,079 in 2006) is still unpaid as at December 31, 2007.

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During fiscal 2007, the company acquired intangible assets of which no amount was unpaid as at December 31, 2007 (an amount of \$31,780 was unpaid as at December 31, 2006).

17 Income taxes

The reconciliation of the income tax recovery, calculated using the statutory income tax rates of the company, with the income tax recovery per the financial statements is as follows:

	2007	2006
Combined Canadian federal and provincial statutory tax rate	32.02%	32.02%
Income tax recovery based on statutory income tax rates	\$ (1,902,415)	\$ (2,483,993)
Non-deductible expenses	56,103	25,865
Non-taxable items	(96,060)	(57,536)
Change in enacted tax rates	1,387,863	512,352
Change in valuation allowance	246,065	1,874,358
Items not affecting earnings	(71,715)	(267,076)
Expiry of loss carry-forward	390,508	390,364
Other	(10,349)	5,666
	<u>\$ -</u>	<u>\$ -</u>

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Notes to Consolidated Financial Statements December 31, 2007 and 2006

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

	2007 \$	2006 \$
Future income tax assets		
Current future income tax assets		
Other	5,361	636
Long-term future income tax assets		
Property, plant and equipment	45,654	-
Intangible assets	146,989	136,923
Research and development expenses	2,987,331	2,674,442
Non-capital losses	6,495,070	6,531,429
Financing expenses	71,109	134,421
Federal contribution	224,129	122,148
Other	3,106	2,843
	<u>9,973,388</u>	<u>9,602,206</u>
	9,978,749	9,602,842
Valuation allowance	<u>(9,750,502)</u>	<u>(9,591,271)</u>
Total future income tax assets	<u>228,247</u>	<u>11,571</u>
Future income tax liabilities		
Current future income tax liabilities		
Investment tax credit	(67,318)	-
Long-term future income tax liabilities		
Property, plant and equipment	-	(11,571)
Long-term debt	<u>(160,929)</u>	<u>-</u>
Total future income tax liabilities	<u>(228,247)</u>	<u>(11,571)</u>
Future income taxes, net	<u>-</u>	<u>-</u>

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

As at December 31, 2007, the company has accumulated, for federal and provincial income tax purposes, non-capital losses totalling approximately \$27,878,000 (\$23,327,000 in 2006) and \$22,353,000 (\$18,339,000 in 2006), respectively. These losses can be carried forward against future years' taxable income and will expire as follows:

	Federal \$	Provincial \$
2008	1,215,000	1,230,000
2009	2,302,000	1,405,000
2010	2,566,000	1,733,000
2011	4,522,000	3,847,000
2015	5,450,000	3,943,000
2026	6,966,000	5,788,000
2027	4,857,000	4,407,000
	<u>27,878,000</u>	<u>22,353,000</u>

The company is entitled to a non-refundable federal tax credit of approximately \$716,000. This credit can be applied against future years' taxable income and will expire at the latest in 2015.

18 Commitments

As at December 31, 2007, the balance of commitments on lease agreements and premises amount to \$915,162. Minimum rental amounts for each of the next five fiscal years are as follows: \$153,738 in 2008, \$203,046 in 2009, \$152,286 in 2010 and \$203,046 in 2011 and 2012. The main lease for premises expires in May 2013 with a renewal option of five years.

Under a license obtained from Agriculture and Agri-Food Canada, the company is committed to paying royalties. The minimum royalties for the next ten years amount to \$50,000 per year from 2007 to 2017.

Under a license from the University of Guelph, the company is committed to paying royalties. The minimum royalties for the next seven years amount to \$5,000 per year from 2008 to 2014.

Under a license, the company is committed to paying royalties. Minimum royalties for each of the next five fiscal years are as follows: \$17,000 in 2008, \$47,000 in 2009, \$67,000 in 2010, and \$92,000 in 2011 and 2012. The royalties for this license have a term of nineteen years.

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Notes to Consolidated Financial Statements December 31, 2007 and 2006

19 Financial instruments

Fair value

The company's financial instruments recognized in the balance sheet consist of cash and cash equivalents, accounts receivable, financing receivable, grants receivable, bank loans, accounts payable and accrued liabilities and long-term debt. Cash and cash equivalents are recorded at fair value. The fair value of other financial instruments approximates their carrying value due to their short-term maturity or to current market rates except for the long-term debt. The fair value of the long-term debt approximates its carrying value due to the use of the effective interest rate method.

Credit risk

Financial instruments which potentially subject the company to credit risk consist principally of cash and cash equivalents. The company's cash and cash equivalents are held with or issued by high-credit quality financial institutions; therefore the company considers the risk of non-performance on these instruments to be remote.

Currency risk

Certain company's operations are denominated in euros. Accordingly, certain items recorded in the balance sheet or in the statement of earnings are exposed to currency fluctuations.

Interest rate risk

As at December 31, 2007, the company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Variable interest rate
Accounts receivable	Non-interest bearing
Financing receivable	Non-interest bearing
Grants receivable	Non-interest bearing
Bank loans	As described in note 9
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 11

20 Earnings 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 earnings per share calculations:

	2007	2006
Basic and diluted weighted average number of shares outstanding	19,445,773	11,475,571

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

For the years ended December 31, 2007 and 2006, the diluted loss per share was the same as the basic loss per share since there were no dilutive items. Stock options, unit options and warrants have been excluded from the diluted loss per share calculations since the exercise price of these items was greater than the average market price of the common shares. Accordingly, the diluted loss per share for those years was calculated using the basic weighted average number of shares outstanding.

21 Subsequent events

On February 7, 2008, the company entered into a non-exclusive licensing agreement (the "Agreement") with an undisclosed Fortune 100 Company (the "Partner") for the development and commercialization of the company's proprietary plant-based production technology in exchange for an upfront payment of \$1,500,000 and a payment of \$500,000 upon attainment of an important milestone. Under the terms of the Agreement, Medicago will grant the Partner 2,000,000 common share purchase warrants. Each warrant entitles the Partner to acquire one common share of the company for a period of three years following the execution of the Agreement, at an exercise price of 15% over the market price at the time of execution of this Agreement, during the first year, increased by 10% for each of the two following years.

On March 11, 2008, the company granted 180,000 stock options to employees and directors. The stock options were issued at an exercise price of \$0.66 and expire after a five-year period from the date of grant.

On March 14, 2008, the company completed a private placement of 13,000,000 units (the "Units") at a price of \$0.20 per Unit for gross proceeds of \$2.6 million, each Unit consisting of one common share of the company and one-half common share purchase warrant. Each share purchase warrant entitles the holder thereof to purchase one common share at a price of \$0.25 until March 14, 2010. The company paid a cash finder's fee of 6% in connection with this placement.

On March 26, 2008, the company amended the terms of its loan from Investissement Québec whereby 50% of the interest of fiscal 2008 will be capitalized to the loan in exchange for the issuance of 643,877 warrants expiring in three years with an exercise price corresponding to the weighted average price of the last five days preceding the issue request to the TSX Venture Exchange Inc. This agreement is subject to the TSX Venture Exchange Inc.'s approval.

On March 31, 2008, the company granted 83,850 stock options to an officer and director. The stock options were issued at an exercise price of \$0.62 and expire after a five-year period from the date of grant.