

Management's discussion and analysis

October 15, 2007

PLAN OF ARRANGEMENT AND CORPORATION REORGANIZATION

On July 10, 2007 (the "Arrangement Date"), Lorus Therapeutics Inc. (the "Company or "New Lorus") completed a plan of arrangement and corporate reorganization with, among others, 4325231 Canada Inc., formerly Lorus Therapeutics Inc. ("Old Lorus"), 6707157 Canada Inc. and Pinnacle International Lands, Inc (the "Arrangement"). As a result of the plan of arrangement and reorganization, among other things, each common share of Old Lorus was exchanged for one common share of the Company and the assets (excluding certain future tax attributes and related valuation allowance) and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it) were transferred, directly or indirectly, to the Company and/or its subsidiaries. The Company continued the business of Old Lorus after the Arrangement Date with the same officers and employees and continued to be governed by the same board of directors as Old Lorus prior to the Arrangement Date. Therefore, the Company's operations have been accounted for on a continuity of interest basis and accordingly, the consolidated financial statement information below reflect that of the Company as if it had always carried on the business formerly carried on by Old Lorus. References in this MD&A to the Company, Lorus, "we", "our", "us" and similar expressions, unless otherwise stated, are references to Old Lorus prior to the Arrangement Date and the Company after the Arrangement Date.

On November 1, 2006, the Company was incorporated as 6650309 Canada Inc. pursuant to the provisions of the Canada Business Corporation Act and did not carry out any active business from the date of incorporation to July 10, 2007. From its incorporation to July 10, 2007, the Company was a wholly owned subsidiary of Old Lorus.

In connection with the Arrangement and after the Exchange, the share capital of Old Lorus was reorganized into voting common shares and non-voting common shares and Investor acquired from New Lorus and Selling Shareholders (as defined below) approximately 41% of the voting common shares and all of the non-voting common shares of Old Lorus for a cash consideration of approximately \$8.5 million less an escrowed amount of \$600 thousand, subject to certain post-closing adjustments and before transaction costs. The remaining 59% of the voting common shares of Old Lorus were distributed to the shareholders of New Lorus who were not residents of the United States on a pro-rata basis. Shareholders of New Lorus who were residents of the United States received a nominal cash payment in lieu of their pro-rata share of voting common shares of Old Lorus. After completion of the Arrangement, New Lorus is not related to Old Lorus, which was subsequently renamed 4325231 Canada Inc.

As a condition of the Arrangement, High Tech Beteiligungen GmbH & Co. KG and certain other shareholders of Old Lorus (the "Selling Shareholders") agreed to sell to Investor the voting common shares of Old Lorus to be received under the Arrangement at the same price per share as was paid to shareholders who are residents of the United States. The proceeds received by the Selling Shareholders was nominal.

Also as a condition of the Arrangement, the holder of Old Lorus' secured convertible debenture agreed to vote in favour of the transaction subject to the repurchase by New Lorus of its outstanding three million common share purchase warrants at a purchase price of \$252 thousand upon closing of the Arrangement.

Under the Arrangement, New Lorus and its subsidiaries have agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring (i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the

Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time; (ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and (iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement. As part of the Arrangement, the Company changed its name to Lorus Therapeutics Inc. and continued as a biopharmaceutical company, specializing in the research and development of pharmaceutical products and technologies for the management of cancer as a continuation of the business of Old Lorus.

The Arrangement has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements of New Lorus reflects the financial position, results of operations and cash flows as if New Lorus has always carried on the business formerly carried on by Old Lorus. Consequently, all comparative figures presented in these interim consolidated financial statements are those of Old Lorus.

The following discussion should be read in conjunction with the audited financial statements for the year ended May 31, 2007 and the accompanying notes for 6650309 Canada Inc., subsequently renamed Lorus Therapeutics Inc, (New Lorus) and the financial statements of Lorus Therapeutics Inc. subsequently renamed 4325231 Canada Inc. (Old Lorus) presented in the Supplemental Financial Information (collectively the "Financial Statements") contained in the Company's annual report. The Financial Statements, and all financial information discussed below, have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are expressed in Canadian dollars unless otherwise noted.

OVERVIEW

Lorus Therapeutics Inc. is a life sciences company focused on the discovery, research and development of effective anticancer therapies with a high safety profile. Lorus has worked to establish a diverse anticancer product pipeline, with products in various stages of development ranging from preclinical to multiple Phase II clinical trials. A growing intellectual property portfolio supports our diverse product pipeline.

Our success is dependent upon several factors, including establishing the efficacy and safety of our products in clinical trials, securing strategic partnerships, obtaining the necessary regulatory approvals to market our products and maintaining sufficient levels of funding through public and/or private financing.

We believe that the future of cancer treatment and management lies in drugs that are effective, safe and have minimal side effects, and therefore improve a patient's quality of life. Many of the cancer drugs currently approved for the treatment and management of cancer are toxic with severe side effects, and we therefore believe that a product development plan based on effective and safe drugs could have broad applications in cancer treatment. Lorus' strategy is to continue the development of our product pipeline using several therapeutic approaches. Each therapeutic approach is dependent on different technologies, which we believe mitigates the development risks associated with a single technology platform. We evaluate the merits of each product throughout the clinical trial process and consider commercialability as appropriate. The most advanced anticancer drugs in our pipeline, each of which flow from different platform technologies, are antisense, small molecules and immunotherapeutics.

Our loss from operations for the three months ended August 31, 2007 decreased 25% to \$2.1 million (\$0.01 per share) compared to a net loss of \$2.8 million (\$0.01 per share) in 2006. On close of the Arrangement, the Company realized a gain on the sale of the shares of Old Lorus in the amount of \$6.1 million resulting in income for the period of \$4.0 million (\$0.02 per share). Research and development expenses in the first three months of fiscal 2008 decreased to \$782 thousand from \$1.3 million in

during the same period last year. Research and development costs were significantly lower in 2007 due to reduced external research and testing costs in 2007 as compared to the same period in 2006. In addition, the Company incurred drug manufacturing costs and amortization of acquired R&D costs in 2006 not incurred in 2007. Staff reductions and a continued focus on reducing overhead costs contributed to the decrease. We utilized cash of \$2.3 million in our operating activities in three-month period ended August 31, 2007 compared with \$1.8 million during the same period in 2006; reflecting a reduction in accounts payable and an increase in prepaid and other assets. At August 31, 2007 we had cash and cash equivalents and marketable securities of \$17.1 million compared to \$12.4 million at May 31, 2007.

RESULTS OF OPERATIONS

Revenues

Revenues for the three-month period ended August 31, 2007 increased to \$26 thousand compared with revenue of \$7 thousand for the same period last year. The increase in revenue in the current period is related to increased laboratory services work performed by Lorus personnel on behalf of other companies.

Research and Development

Research and development expenses totaled \$782 thousand in the three-month period ended August 31, 2007 compared to \$1.3 million during the same period last year. The decrease in spending compared with 2006 is due to reduced external research and testing costs in 2007 as compared to the same period in 2006. In addition, the Company incurred drug manufacturing costs and amortization of acquired R&D costs in 2006 not incurred in 2007. The Company continues to leverage its research and development activities through the use of NCI sponsored trials.

General and Administrative

General and administrative expenses totaled \$736 thousand in the three-month period ended August 31, 2007 compared to \$788 thousand in same period last year. The decrease in general and administrative costs is the result of staff reductions, and a continued focus on lowering costs in all areas of the business.

Stock-Based Compensation

Stock-based compensation expense totaled \$103 thousand in the three-month period ended August 31, 2007 compared with \$113 thousand in the same period last year. The decrease in stock-based compensation expense in 2007 is the result of reduced fair values on the stock options issued, due to a decline in our stock price.

Depreciation and Amortization

Depreciation and amortization expenses decreased to \$79 thousand in the three-month period ended August 31, 2007 as compared to \$100 thousand in the same period last year. The decrease in depreciation and amortization expense is the result of reduced capital asset purchases during fiscal 2007 and 2006.

Interest Expense

Non-cash interest expense was \$270 thousand in the three-month period ended August 31, 2007 compared with \$265 thousand in the same period last year. These amounts represent interest at a rate of prime plus 1% on the \$15.0 million convertible debentures. The increase in interest expense in 2007 compared with 2006 is a function of a higher prime rate in July 2007. All interest accrued on the debentures to date has been paid in common shares of the Company.

Accretion in Carrying Value of Secured Convertible Debentures

Accretion in the carrying value of the Company's secured convertible debentures amounted to \$266 thousand in the three-month period ended August 31, 2007 compared with \$219 thousand in the same period last year. The accretion charges arise as under GAAP the Company has allocated the proceeds

from each tranche of the debentures to the debt and equity instruments issued on a relative fair value basis resulting in the \$15.0 million debentures having an initial cumulative carrying value of \$9.8 million as of their dates of issuance. Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be the face value of \$15.0 million. The increase in expense in 2007 compared with 2006 is due to higher effective rate of interest.

Amortization of Deferred Financing Charges

Amortization of deferred financing charges totaled \$32 thousand in the three-month period ended August 31, 2007 compared with \$25 thousand in the same period last year. The deferred financing charges relate to the convertible debenture transaction and is being amortized using the effective interest rate method over the five-year life of the debt commencing October 6, 2004.

Interest and Other Income

Interest income totaled \$140 thousand in the three-month period ended August 31, 2007 compared to \$67 thousand in the same period last year. The amount of Interest income in the current period has been offset by the a \$20 thousand loss in fair value on investments held-for-trading as a result of the implementation on the new financial instruments accounting policy, see Recently Adopted Accounting Policies, below. The overall increase interest income in the current period is due to higher average cash and marketable securities balances in the current three month period compared to the same period in 2006 as well as higher interest rates. Higher average cash and marketable securities balances were primarily a function of the funds received as part to of the August 2006 private placements and the completion of the Arrangement in July 2007.

Loss from operations for the period

Operating net loss for the period, before the gain on sale of shares associated with the completion of the Arrangement decreased to \$2.1 million or \$0.01 per share in the first three month ended August 31, 2007 compared to \$2.8 million or \$0.01 per share in the same period last year. The decrease in net loss in 2007 compared with 2006 is primarily due to lower research and development costs as discussed above.

Gain on sale of shares

As a result of the Arrangement, the Company recognized a gain on the sale of the shares of Old Lorus to the Investor of approximately \$6.1 million. Under the Arrangement, numerous steps were undertaken as part of a taxable reorganization. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately \$7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement as described above. Those tax attributes remaining with Old Lorus are no longer available to the Company. In reference to those indemnifications, \$600 thousand of the proceeds on the transaction have been held in escrow until the first anniversary of the transaction (July 2008). The Company has deferred any gain on this escrow amount until they are released at which time the fair value of the indemnity will be reassessed.

CORPORATE CHANGES

As discussed above, On July 10, 2007, the Company and Old Lorus completed a plan of arrangement and corporate reorganization with, among others, 6707157 Canada Inc. and Pinnacle International Lands, Inc. As part of the Arrangement, all of the assets and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it), with the exception of certain future tax assets were transferred, directly or indirectly, from Old Lorus to the Company. Securityholders in Old Lorus exchanged their securities in Old Lorus for equivalent securities in New Lorus and the board of directors and management of Old Lorus continued as the board of directors and management of New Lorus. New Lorus obtained substitutional listings of its common shares on both the Toronto Stock Exchange and the American Stock Exchange.

As part of the Arrangement, the Company changed its name to Lorus Therapeutics Inc. and continued as a biopharmaceutical company, specializing in the research and development of pharmaceutical products and technologies for the management of cancer as a continuation of the business of Old Lorus.

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The selected financial information provided below is derived from the Company's unaudited quarterly financial statements for each of the last eight quarters.

Research and development expenses continue to trend lower than in the same quarters in the previous year as a result of the reduction in R&D costs following the close of our Phase III Virulizin[®] clinical trials and the full amortization of acquired R&D in August 2006. Overall, R&D costs are lower as the company continues to leverage its clinical trial costs utilizing National Cancer Institute sponsored trials.

General and administrative expenses have remained relatively consistent across last six quarters and with the exception of an increase for the quarter ended November 30, 2006 due to severance charges relating to the costs of the mutual separation agreement as described in the Company's annual report.

The Company recognized a gain in the current period as a result of the gain on sale of shares recognized on the close of the Arrangement as discussed above.

<i>(Amounts in 000's except for per common share data)</i>	Aug 31, 2007	May 31, 2007	Feb. 28, 2007	Nov. 30, 2006	Aug. 31, 2006	May 31, 2006	Feb. 28, 2006	Nov. 30, 2005
Revenue	\$26	\$ 40	\$ 37	\$ 23	\$ 7	\$ 14	\$ 5	\$ 6
Research and development	782	259	672	1,122	1,331	1,353	2,296	2,631
General and administrative	736	820	833	1,407	788	730	909	1,619
Net profit (loss)	3,991	(1,689)	(2,062)	(3,117)	(2,770)	(2,970)	(4,095)	(5,102)
Basic and diluted net profit (loss) per share	\$0.02	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.03)
Cash used in operating activities	\$ (2,348)	\$ (89)	\$ (1,805)	\$ (2,585)	\$ (1,814)	\$ (1,940)	\$ (3,956)	\$ (2,360)

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity and debt financing, the proceeds from exercise of warrants and stock options, and interest income on funds held for future investment. We continue to leverage the ongoing costs of the six GTI-2040 Phase II clinical trials through work being done by the US NCI at its cost. These trials are currently in the late stages of completion; Lorus intends to continue an expanded GTI-2040 trial at its own cost. The Company has sufficient GTI-2040 drug to support ongoing trials. The Company is currently in the assessment phase of results from its GTI-2501 Phase II clinical trial and is not incurring significant costs thereon. We will continue the development of our small molecule programs from internal resources until their anticipated completion.

We have not earned substantial revenues from our drug candidates and are therefore considered to be in the development stage. The continuation of our research and development activities and the commercialization of the targeted therapeutic products are dependent upon our ability to successfully finance and complete our research and development programs through a combination of equity financing and payments from strategic partners. We have no current sources of payments from strategic partners. In addition, we will need to repay or refinance the secured convertible debentures

on their maturity should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further clinical development of our products or to repay the convertible debentures on maturity. If we are not able to raise additional funds, we may not be able to continue as a going concern and realize our assets and pay our liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for our financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

We believe our current level of cash and marketable securities sufficient to execute our current planned expenditures for the next twelve months.

Cash Position

At August 31, 2007, Lorus had cash and cash equivalents and short term investments totaling \$17.1 million compared to \$12.4 million at May 31, 2007. The Company invests in highly rated and liquid debt instruments. Investment decisions are made in accordance with an established investment policy administered by senior management and overseen by the board of directors. Working capital (representing primarily cash, cash equivalents and short term investments less current liabilities) at August 31, 2007 was \$15.9 million as compared to \$6.2 million at May 31, 2007.

We do not expect to generate positive cash flow from operations in the next several years due to additional research and development costs, including costs related to drug discovery, preclinical testing, clinical trials, manufacturing costs and operating expenses associated with supporting these activities. Negative cash flow will continue until such time, if ever, that we receive regulatory approval to commercialize any of our products under development and revenue from any such products exceeds expenses.

We may seek to access the public or private equity markets from time to time, even if we do not have an immediate need for additional capital at that time. We intend to use our resources to fund our existing drug development programs and develop new programs from our portfolio of preclinical research technologies. The amounts actually expended for research and drug development activities and the timing of such expenditures will depend on many factors, including the progress of the Company's research and drug development programs, the results of preclinical and clinical trials, the timing of regulatory submissions and approvals, the impact of any internally developed, licensed or acquired technologies, our ability to find suitable partnership agreements to assist financially with future development, the impact from technological advances, determinations as to the commercial potential of the Company's compounds and the timing and development status of competitive products.

Contractual obligations and Off-Balance Sheet Financing

At August 31, 2007, we had contractual obligations requiring annual payments as follows:
(Amounts in 000's)

	Less than 1 year	1-3 years	4-5 years	5+ years	Total
Operating leases	86	5	—	—	91
Convertible Debenture ¹	—	15,000	—	—	15,000
Total	86	15,005	—	—	15,091

¹ The convertible debentures as described above may be converted into common shares of Lorus at a conversion price of \$1.00. In the event that the holder does not convert the debentures, Lorus has an obligation to repay the \$15.0 million in cash. The amounts above excludes interest expense which is payable monthly by issuance of commons shares which is calculated at a rate of prime plus 1% on the outstanding balance.

As at August 31, 2007, we have not entered into any off- balance sheet arrangements.

Outlook

Until one of our drug candidates receives regulatory approval and is successfully commercialized, Lorus will continue to incur operating losses. The magnitude of these operating losses will be largely affected by the timing and scope of future research and development, clinical trials and other development activities related to the Company's lead products, as well as any new initiatives. Finally, the duration of the operating losses will depend on the scientific results of such clinical trials.

SUBSEQUENT EVENTS

Subsequent to August 31, 2007, the Company extended the option exercise period to those directors not seeking re-election at the annual general meeting and Dr. Wright in relation to his options earned as president and chief executive officer. These transactions result in modification of the terms of the original awards, and the incremental compensation expense relating to the modified options will be accounted for in the second quarter ended November 30, 2007.

Also subsequent to August 31, 2007, the Company received a statement of claim in respect of a dispute with a former employee. It is currently not possible to determine the outcome of such action or the amount of settlement if any, but the Company believes that the suit is without merit and will defend the action vigorously. No provision has been made in the consolidated financial statements.

RISK FACTORS

Before making an investment decision with respect to our common shares, you should carefully consider the following risk factors, in addition to the other information included or incorporated by reference into this report. The risks set out below are not the only risks we face. If any of the following risks occur, our business, financial condition, prospects or results of operations would likely suffer. In that case, the trading price of our common shares could decline and you may lose all or part of the money you paid to buy our common shares.

Please refer to the MD&A included in our 2007 Annual Report for a complete discussion of risks and uncertainties.

- We have a history of operating losses. We expect to incur net losses and we may never achieve or maintain profitability.
- Our cash flow may not be sufficient to cover interest payments on our secured convertible debentures or to repay the debentures at maturity.
- We may violate one or more of the operational covenants related to our convertible debentures that could result in an event of default and the requirement for early payment of our convertible debentures.
- We may be unable to obtain partnerships for one or more of our product candidates which could curtail future development and negatively impact our share price.
- Clinical trials are long, expensive and uncertain processes and Health Canada or the FDA may ultimately not approve any of our product candidates. We may never develop any commercial drugs or other products that generate revenues.
- As a result of intense competition and technological change in the pharmaceutical industry, the marketplace may not accept our products or product candidates, and we may not be able to compete successfully against other companies in our industry and achieve profitability.
- If we fail to attract and retain key employees, the development and commercialization of our products may be adversely affected.
- We may be unable to obtain patents to protect our technologies from other companies with competitive products, and patents of other companies could prevent us from manufacturing, developing or marketing our products.
- Our products and product candidates may infringe the intellectual property rights of others, which could increase our costs.

- If product liability claims are brought against us or we are unable to obtain or maintain product liability insurance, we may incur substantial liabilities that could reduce our financial resources.
- We have no manufacturing capabilities. We depend on third-parties, including a number of sole suppliers, for manufacturing and storage of our product candidates used in our clinical trials. Product introductions may be delayed or suspended if the manufacture of our products is interrupted or discontinued.
- Our operations involve hazardous materials and we must comply with environmental laws and regulations, which can be expensive and restrict how we do business.
- We have limited sales, marketing and distribution experience.
- Our interest income is subject to fluctuations of interest rates in our investment portfolio.
- Because of the uncertainty of pharmaceutical pricing, reimbursement and healthcare reform measures, if any of our product candidates are approved for sale to the public, we may be unable to sell our products profitably.
- Our share price has been and may continue to be volatile and an investment in our common shares could suffer a decline in value.
- Future sales of our common shares by us or by our existing shareholders could cause our share price to fall.
- Conversion of our secured convertible debentures will dilute the ownership interest of existing shareholders.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Policies and Estimates

Our accounting policies are in accordance with Canadian GAAP including some that require management to make assumptions and estimates that could significantly affect the results of operations and financial position. The significant accounting policies that we believe are the most critical in fully understanding and evaluating the reported financial results are disclosed in the MD&A section of our 2007 annual report. As well, our significant accounting policies are disclosed in Note 2, *Significant Accounting Policies*, of the notes to the financial statements of Old Lorus (subsequently renamed 4325231 Canada Inc.) provided as Supplemental Financial Information in our annual report for the fiscal year ended May 31, 2007.

Recently Adopted Accounting Recommendations

Effective on June 1, 2007, the Company adopted the recommendations of CICA Handbook Section 1530, Comprehensive Income ("Section 1530"); Section 3855, Financial Instruments - Recognition and Measurement ("Section 3855"); Section 3861, Financial Instruments - Disclosure and Presentation; and Section 3251, Equity. These sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP.

Adoption of the above recommendations had the following impact on the current financial statements:

Short term investments:

Short term investments consist of fixed income government investments and corporate instruments. Any fixed income government investments and corporate instruments that are not cash equivalents are classified as held-to-maturity investments except where the Company cannot reasonably demonstrate that the investment could be expected to be held to maturity by virtue of its long term nature in which case the investment instrument is considered a held-for-trading investment. Held-to-maturity investments are measured at amortized cost while held-for-trading investments are measured at fair value and the resulting gain or loss is recognized in the consolidated statement of loss and deficit. As a result of adopting the new standards, the Company designated certain corporate instruments previously carried at amortized cost as held for trading investments. This change in accounting policy resulted in a reduction

of the opening deficit accumulated during the development stage by \$27 thousand and recognized a loss in the consolidated statement of loss and deficit in the current period of \$20 thousand.

Embedded derivatives:

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

The Company did not identify any embedded derivatives that required separation from the related host contract as at June 1, 2007 that resulted in a material adjustment to the consolidated interim financial statements.

Transaction costs:

Transactions costs that are directly attributable to the acquisition or issuance of financial assets or liabilities are accounted for as part of the respective asset or liability's carrying value at inception.

Guarantee:

On July 10, 2007, as part of the Arrangement, the Company, including its subsidiaries, indemnified Old Lorus and its directors. This indemnity is required to be accounted for at fair value in accordance with Section 3855. Management has accrued an amount of \$600 thousand being the amount held in escrow and has recorded this amount as a deferred gain on sale of shares within its liabilities. The fair value of the indemnity will be reassessed as the escrowed amount is released in July 2008.

Recent Accounting Recommendations not yet adopted

In October 2006, the AcSB approved disclosure and presentation requirements for financial instruments that revise and enhance the disclosure requirements of Section 3861. These requirements included Sections 3862 – Financial Instruments – Disclosure, which replaces Section 3861 and Section 1535, Capital Disclosures ("Section 1535"), which establishes standards for disclosing information about an entity's capital and how it is managed.

Section 3862 is based on IFRS 7, "Financial Instruments: Disclosures", and places an increased emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. Section 3862 requires disclosures, by class of financial instrument that enables users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable.

Section 3863 "Financial Instruments – Presentation", which replaces Section 3861, "Financial Instruments – Disclosure and Presentation". The existing requirements on presentation of financial instruments have been carried forward unchanged to Section 3863, "Financial Instruments – Presentation".

These new Sections are effective for interim and annual financial statements with fiscal years beginning on or after October 1, 2007, but may be adopted in place of Section 3861 before that date

Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for us for interim and annual financial statements relating to fiscal years beginning on

December 1, 2007. Early adoption is permitted at the same time an entity adopts other standards relating to accounting for financial instruments.

We do not expect the adoption of these standards to have a material impact on our consolidated financial position and results of operations.

UPDATED SHARE INFORMATION

As at October 15, 2007, the Company had 213,923,534 common shares issued and outstanding. In addition, the Company had issued and outstanding 15,051,338 stock options to purchase an equal number of common shares and a \$15 million convertible debenture convertible into common shares of Lorus at \$1.00 per share.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This management discussion and analysis may contain forward-looking statements within the meaning of Canadian and U.S. securities laws. Such statements include, but are not limited to, statements relating to:

- *our expectations regarding future financings;*
- *our plans to conduct clinical trials;*
- *our expectations regarding the progress and the successful and timely completion of the various stages of our drug discovery, preclinical and clinical studies and the regulatory approval process;*
- *our plans to obtain partners to assist in the further development of our product candidates; and*
- *our expectations with respect to existing and future corporate alliances and licensing transactions with third parties, and the receipt and timing of any payments to be made by us or to us in respect of such arrangements,*

the Company's plans, objectives, expectations and intentions and other statements including words such as "anticipate", "contemplate", "continue", "believe", "plan", "estimate", "expect", "intend", "will", "should", "may", and other similar expressions.

Such statements reflect our current views with respect to future events and are subject to risks and uncertainties and are necessarily based upon a number of estimates and assumptions that, while considered reasonable by us are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements, including, among others:

- *our ability to obtain the substantial capital required to fund research and operations;*
- *our lack of product revenues and history of operating losses;*
- *our early stage of development, particularly the inherent risks and uncertainties associated with (i) developing new drug candidates generally, (ii) demonstrating the safety and efficacy of these drug candidates in clinical studies in humans, and (iii) obtaining regulatory approval to commercialize these drug candidates;*
- *our drug candidates require time-consuming and costly preclinical and clinical testing and regulatory approvals before commercialization;*
- *clinical studies and regulatory approvals of our drug candidates are subject to delays, and may not be completed or granted on expected timetables, if at all, and such delays may increase our costs and could delay our ability to generate revenue;*
- *the regulatory approval process;*
- *the progress of our clinical trials;*

- *our ability to find and enter into agreements with potential partners;*
- *our ability to attract and retain key personnel;*
- *our ability to obtain patent protection and protect our intellectual property rights;*
- *our ability to protect our intellectual property rights and to not infringe on the intellectual property rights of others;*
- *our ability to comply with applicable governmental regulations and standards;*
- *development or commercialization of similar products by our competitors, many of which are more established and have greater financial resources than we do;*
- *commercialization limitations imposed by intellectual property rights owned or controlled by third parties;*
- *our business is subject to potential product liability and other claims;*
- *our ability to maintain adequate insurance at acceptable costs;*
- *further equity financing may substantially dilute the interests of our shareholders;*
- *changing market conditions; and*
- *other risks detailed from time-to-time in our ongoing quarterly filings, annual information forms, annual reports and annual filings with Canadian securities regulators and the United States Securities and Exchange Commission, and those which are discussed under the heading "Risk Factors".*

Should one or more of these risks or uncertainties materialize, or should the assumptions set out in the section entitled "Risk Factors" underlying those forward-looking statements prove incorrect, actual results may vary materially from those described herein. These forward-looking statements are made as of the date of this annual information form or, in the case of documents incorporated by reference herein, as of the date of such documents, and we do not intend, and do not assume any obligation, to update these forward-looking statements, except as required by law. We cannot assure you that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements. Investors are cautioned that forward-looking statements are not guarantees of future performance and accordingly investors are cautioned not to put undue reliance on forward-looking statements due to the inherent uncertainty therein.

ADDITIONAL INFORMATION

Additional information relating to Lorus, including Lorus' 2007 annual information form and other disclosure documents, is available on SEDAR at www.sedar.com. For any information filed prior to July 10, 2007 please access the information on SEDAR for 4325231 Canada Inc. (Old Lorus)

Lorus Therapeutics Inc.
Interim Consolidated Balance Sheets

<i>(amounts in 000's)</i> <i>(Canadian dollars)</i>	As at August 31, 2007 (Unaudited)	As at May 31, 2007
ASSETS		
Current		
Cash and cash equivalents	\$ 3,382	\$ 1,405
Short term investments (note 5)	13,686	7,265
Prepaid expenses and other assets	727	335
Amount held in escrow (note 1)	600	-
	18,395	9,005
Long-term		
Marketable securities and other investments (note 5)	-	3,728
Fixed assets	462	503
Deferred arrangement costs	-	1,262
Goodwill	606	606
	1,068	6,099
	\$ 19,463	\$ 15,104
LIABILITIES		
Current		
Accounts payable	\$ 1,022	\$ 1,104
Liability to repurchase warrants	-	252
Deferred gain on sale of shares (note 1)	600	-
Accrued liabilities	880	1,421
	2,502	2,777
Long-term		
Secured convertible debentures (note 6)	11,863	11,566
SHAREHOLDERS' EQUITY		
Common shares (note 3)	157,984	157,714
Equity portion of secured convertible debentures	3,814	3,814
Stock options (note 4(c))	4,983	4,898
Contributed surplus (note 3(e))	8,543	8,525
Accumulated other comprehensive income	-	-
Deficit accumulated during development stage	(170,226)	(174,190)
	5,098	761
	\$ 19,463	\$ 15,104

*See accompanying notes to the unaudited consolidated interim financial statements
Basis of Presentation (note 1)*

Lorus Therapeutics Inc.
Interim Consolidated Statements of Loss and Deficit (unaudited)

<i>(amounts in 000's except for per common share data)</i> <i>(Canadian dollars)</i>	Three months ended Aug. 31, 2007	Three months ended Aug. 31, 2006	Period from inception Sept. 5, 1986 to Aug 31, 2007
REVENUE	\$ 26	\$ 7	\$ 839
EXPENSES			
Cost of sales	1	3	104
Research and development	782	1,331	114,641
General and administrative	736	788	52,059
Stock-based compensation (note 4)	103	113	7,356
Depreciation and amortization of fixed assets	79	100	9,304
Operating expenses	1,701	2,335	183,464
Interest expense on convertible debentures	270	265	2,502
Accretion in carrying value of convertible debentures	266	219	2,417
Amortization of deferred financing charges	32	25	313
Interest income	(140)	(67)	(11,564)
Loss from operations for the period	2,103	2,770	176,293
Gain on sale of shares (note 1)	(6,094)	-	(6,094)
Net (earnings)/loss and other comprehensive income for the period	(3,991)	2,770	170,199
Deficit, beginning of period as previously reported	174,190	164,554	-
Change in accounting policy (note 2)	27	-	27
Deficit, beginning of period as revised	174,217	164,554	-
Deficit, end of period	\$ 170,226	\$ 167,324	\$ 170,226
Basic (earnings) loss per common share	\$ (0.02)	\$ 0.01	
Diluted (earnings) loss per common share	\$ (0.02)	n/a	
Weighted average number of common shares			
outstanding used in the calculation of:			
Basic (earnings) loss per share	213,057	186,529	
Diluted (earnings) loss per share	227,266	n/a	

See accompanying notes to the unaudited consolidated interim financial statements

Lorus Therapeutics Inc.
Interim Consolidated Statements of Cash Flows (unaudited)

<i>(amounts in 000's)</i> <i>(Canadian Dollars)</i>	Three months ended Aug. 31, 2007	Three months ended Aug. 31, 2006	Period from inception Sept. 5, 1986 to Aug. 31, 2007
Cash flows from operating activities:			
Earnings (loss) for the period	\$ 3,991	\$ (2,770)	\$ (170,199)
Less: Gain on sale of shares	(6,094)	-	(6,094)
Items not involving cash:			
Stock-based compensation	103	113	7,356
Interest on convertible debentures	270	265	2,502
Accretion in carrying value of convertible debentures	266	219	2,417
Amortization of deferred financing charges	32	25	313
Depreciation, amortization and write-down of fixed assets and acquired patents and licenses	79	493	21,865
Other	20	-	727
Change in non-cash operating working capital	(1,015)	(159)	267
Cash used in operating activities	(2,348)	(1,814)	(140,846)
Cash flows from financing activities:			
Issuance of debentures, net of issuance costs	-	-	12,948
Issuance of warrants	-	-	37,405
Repurchase of warrants	(252)	-	(252)
Proceeds on sale of shares, net of amount held in escrow and arrangement costs	7,356	-	6,094
Issuance of common shares, net	-	11,654	109,025
Additions to deferred financing charges	-	-	(245)
Cash provided by financing activities	7,104	11,654	164,975
Cash flows from investing activities:			
Maturity (purchase) of marketable securities and other investments, net	(2,740)	754	(13,733)
Business acquisition, net of cash received	-	-	(539)
Acquired patents and licenses	-	-	(715)
Additions to fixed assets	(39)	-	(6,108)
Proceeds on sale of fixed assets	-	-	348
Cash provided by (used in) investing activities	(2,779)	754	(20,747)
Increase (decrease) in cash and cash equivalents	1,977	10,594	3,382
Cash and cash equivalents, beginning of period	1,405	2,692	-
Cash and cash equivalents, end of period	\$ 3,382	\$ 13,286	\$ 3,382

See accompanying notes to the unaudited consolidated interim financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

1. Basis of presentation

These unaudited interim consolidated financial statements of Lorus Therapeutics Inc., formerly 6650309 Canada Inc. (the "Company" or "New Lorus") have been prepared by the Company in accordance with Canadian generally accepted accounting principles for interim financial statements and do not include all the information required for complete financial statements. The unaudited interim financial statements follow the same accounting policies and methods of application as the audited annual financial statements for the year ended May 31, 2007. These statements should be read in conjunction with the audited consolidated financial statements for the year ended May 31, 2007, including the Supplemental Financial Information attached thereto.

a) Reorganization

On November 1, 2006, the Company was incorporated as 6650309 Canada Inc. pursuant to the provisions of the Canada Business Corporation Act and did not carry out any active business from the date of incorporation to July 10, 2007. From its incorporation to July 10, 2007, the Company was a wholly owned subsidiary of 4325231 Canada Inc, formerly Lorus Therapeutics Inc. ("Old Lorus").

On July 10, 2007, the Company and Old Lorus completed a plan of arrangement and corporate reorganization with, among others, 6707157 Canada Inc. (the "Investor") and its affiliate, Pinnacle International Lands, Inc. (the "Arrangement"). As part of the Arrangement, all of the assets and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it), with the exception of certain future tax assets were transferred, directly or indirectly, from Old Lorus to the Company. Securityholders in Old Lorus exchanged their securities in Old Lorus for equivalent securities in New Lorus (the "Exchange") and the board of directors and management of Old Lorus continued as the board of directors and management of New Lorus. New Lorus obtained substitutional listings of its common shares on both the Toronto Stock Exchange and the American Stock Exchange.

In connection with the Arrangement and after the Exchange, the share capital of Old Lorus was reorganized into voting common shares and non-voting common shares and Investor acquired from New Lorus and Selling Shareholders (as defined below) approximately 41% of the voting common shares and all of the non-voting common shares of Old Lorus for a cash consideration of approximately \$8.5 million less an escrowed amount of \$600 thousand, subject to certain post-closing adjustments and before transaction costs. The remaining 59% of the voting common shares of Old Lorus were distributed to the shareholders of New Lorus who were not residents of the United States on a pro-rata basis. Shareholders of New Lorus who were residents of the United States received a nominal cash payment in lieu of their pro-rata share of voting common shares of Old Lorus. After completion of the Arrangement, New Lorus is not related to Old Lorus, which was subsequently renamed 4325231 Canada Inc.

As a condition of the Arrangement, High Tech Beteiligungen GmbH & Co. KG and certain other shareholders of Old Lorus (the "Selling Shareholders") agreed to sell to Investor the voting common shares of Old Lorus to be received under the Arrangement at the same price per share as was paid to shareholders who are residents of the United States. The proceeds received by the Selling Shareholders was nominal.

Also as a condition of the Arrangement, the holder of Old Lorus' secured convertible debenture agreed to vote in favour of the transaction subject to the repurchase by New Lorus of its outstanding three million common share purchase warrants at a purchase price of \$252 thousand upon closing of the Arrangement.

Under the Arrangement, New Lorus and its subsidiaries have agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring (i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time; (ii) prior to, at or after the Effective Time as a result of any and all interests, rights,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and (iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

As part of the Arrangement, the Company changed its name to Lorus Therapeutics Inc. and continued as a biopharmaceutical company, specializing in the research and development of pharmaceutical products and technologies for the management of cancer as a continuation of the business of Old Lorus.

The Arrangement has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements of New Lorus reflects the financial position, results of operations and cash flows as if New Lorus has always carried on the business formerly carried on by Old Lorus. Consequently, all comparative figures presented in these interim consolidated financial statements are those of Old Lorus.

As a result of the Arrangement, the Company recognized a gain on the sale of the shares of Old Lorus to the Investor of approximately \$6.1 million. Under the Arrangement, numerous steps were undertaken as part of a taxable reorganization. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately \$7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement as described above. Those tax attributes remaining with Old Lorus are no longer available to the Company. In reference to those indemnifications, \$600 thousand of the proceeds on the transaction have been held in escrow until the first anniversary of the transaction (July 2008). The Company has deferred any gain on this escrow amount until they are released at which time the fair value of the indemnity will be reassessed.

The information presented as at August 31, 2007 and for the three months ended August 31, 2007 and August 31, 2006 reflect, in the opinion of management, all adjustments consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

b) Future operations

The Company has not earned substantial revenues from its drug candidates and is therefore considered to be in the development stage. The continuation of the Company's research and development activities is dependent upon the Company's ability to successfully finance its cash requirements through a combination of equity financing and payments from strategic partners. The Company has no current sources of payments from strategic partners. In addition, the Company will need to repay or refinance the secured convertible debentures on their maturity should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further development of the Company's product candidates or to repay the convertible debentures on maturity.

Management believes that the Company's current level of cash and short term investments will be sufficient to execute the Company's current planned expenditures for the next twelve months. If the Company is not able to raise additional funds, it may not be able to continue as a going concern and realize its assets and pay its liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

2. *Change in Accounting policy—Financial instruments*

Effective June 1, 2007, the Company adopted the recommendations of CICA Handbook Section 1530, Comprehensive Income ("Section 1530"); Section 3855, Financial Instruments - Recognition and Measurement ("Section 3855"), retroactively without restatement of prior periods. These sections provide standards for recognition, measurement, disclosure and presentation of financial assets,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

financial liabilities and non-financial derivatives. Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP. As a result of adopting the above standards, the Company did not recognize any other comprehensive income in its financial statements.

Upon adoption of the new standards on June 1, 2007, the Company designated its financial assets and liabilities as follows:

Cash and cash equivalents:

Cash and cash equivalents as at June 1, 2007 and acquired thereafter continue to be classified as held-for-trading investments and measured at fair value. By virtue of the nature of these assets, fair value is generally equal to cost plus accrued interest. Where applicable, any significant change in market value would result in a gain or loss being recognized in the consolidated statement of loss and deficit. As a result of adopting the new standards, there was no material change in valuation of these assets resulting in a gain or loss to be recognized in the current financial statements.

Short term investments:

Short term investments consist of fixed income government investments and corporate instruments. Any fixed income government investments and corporate instruments that are not cash equivalents are classified as held-to-maturity investments except where the Company cannot reasonably demonstrate that the investment could be expected to be held to maturity by virtue of its long term nature in which case the investment instrument is considered a held-for-trading investment. Held-to-maturity investments are measured at amortized cost while held-for-trading investments are measured at fair value and the resulting gain or loss is recognized in the consolidated statement of loss and deficit. As a result of adopting the new standards, the Company designated certain corporate instruments previously carried at amortized cost as held for trading investments. This change in accounting policy resulted in a reduction of the opening deficit accumulated during the development stage by \$27 thousand and recognized a loss in the consolidated statement of loss and deficit in the current period of \$20 thousand.

Accounts payable and accrued liabilities:

Accounts payable and accrued liabilities are typically short-term in nature and classified as other financial liabilities. These liabilities are valued at amortized cost. As a result of adopting the new standards, there was no material change in valuation of these liabilities resulting in a gain or loss to be recognized in the current financial statements.

Secured convertible debentures:

The secured convertible debentures are classified as other financial liabilities and accounted for at amortized cost using the effective interest method, which is consistent with the Company's accounting policy prior to the adoption of Section 3855. The deferred financing charges related to the secured convertible debentures, formerly included in long term assets, are now included as part of the carrying value of the secured convertible debentures and continue to be amortized using the effective interest method (\$339 thousand at August 31, 2007).

Embedded derivatives:

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

The Company did not identify any embedded derivatives that required separation from the related host contract as at June 1, 2007 that resulted in a material adjustment to the consolidated interim financial statements.

Transaction costs:

Transactions costs that are directly attributable to the acquisition or issuance of financial assets or liabilities are accounted for as part of the respective asset or liability's carrying value at inception.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

Guarantee:

On July 10, 2007, as part of the Arrangement, the Company, including its subsidiaries, indemnified Old Lorus and its directors (note 1). This indemnity is required to be accounted for at fair value in accordance with Section 3855. Management has accrued an amount of \$600 thousand being the amount held in escrow and has recorded this amount as a deferred gain on sale of shares within its liabilities. The fair value of the indemnity will be reassessed as the escrowed amount is released in July 2008.

3. Share capital

(a) Continuity of common shares and warrants

(Amounts and units in 000's except Original Share amount)	Common shares		Warrants	
	Number	Amount	Number	Amount
Balance at November 30, 2006				
Original Share	1	\$ 1	—	\$ —
Balance, May 31, 2007	1	\$ 1	—	\$ —
Surrender of Original Share	(1)	(1)	—	—
Share Exchange (note 1)	212,628	157,800	—	—
Interest payments (note b)	865	184	—	—
Balance, August 31, 2007	213,493	\$ 157,984	—	\$ —

On July 10, 2007 as part of the Arrangement described in note 1, the Company surrendered its Original Share, and exchanged all of the shares in Old Lorus for an equivalent number of shares of the Company. Based on a continuity of interests accounting, the following share transactions reflect transactions in share capital as if the Company has always carried on the business of Old Lorus:

(amounts and units in 000's)	Common Shares		Warrants	
	Number	Amount	Number	Amount
Balance at May 31, 2006	174,694	\$145,001	3,000	\$ 991
Equity issuance (c)	33,800	11,640	—	—
Interest payments (b)	792	265	—	—
Stock option exercises	46	22	—	—
Balance at August 31, 2006	209,332	\$156,928	3,000	\$ 991
Interest payments (b)	1,031	262	—	—
Balance at November 30, 2006	210,363	\$157,190	3,000	\$ 991
Interest payments (b)	915	259	—	—
Balance at February 28, 2007	211,278	\$157,449	3,000	\$ 991
Interest payments (b)	988	265	—	—
Repurchase of Warrants	—	—	(3,000)	(991)
Balance at May 31, 2007	212,266	\$157,714	—	—
Interest payments (b)	1,227	270	—	—
Balance at August 31, 2007	213,493	\$157,984	—	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

(b) Interest payments

Interest payments relate to interest payable on the \$15.0 million convertible debentures payable at a rate of prime +1% until such time as the Company's share price reaches \$1.75 for 60 consecutive trading days, at which time, interest will no longer be charged. Common shares issued in payment of interest were issued at a price equal to the weighted average trading price of such shares for the ten trading days immediately preceding their issue in respect of each interest payment.

(c) Equity issuances

On July 10, 2007 as part of the Arrangement described in note 1, the Company surrendered its Original Share, and exchanged all of the shares in Old Lorus for an equivalent number of shares of the Company. The transactions below occurred in Old Lorus, however as a result of the exchange in shares, the shares issued in these transactions became shares in New Lorus.

On August 30, 2006, the Company raised gross proceeds of \$10.4 million by way of a subscription agreement for 28.8 million common shares at a price of \$0.36 per common share. The 28.8 million common shares have been qualified for distribution in Canada under a short form prospectus filed on August 25, 2006 with the Ontario Securities Commission. In connection with the transaction, the investor received demand registration rights that will enable the investor to request the registration or qualification of the common shares for resale in the United States and Canada, subject to certain restrictions. These demand registration rights will expire on June 30, 2012.

On August 31, 2006, the Company raised gross proceeds of \$1.8 million by way of a private placement for 5.0 million common shares at a price of \$0.36 per common share.

The Company incurred expenses of \$527 thousand related to these issuances, which have been recorded as a reduction to share capital.

During the quarter ended August 31, 2007, nil stock options were exercised (August 31, 2006 – 46 thousand stock options were exercised for proceeds of \$14 thousand)

(d) Earnings/Loss per share

For the three months ended August 31, 2007, the determination of diluted earnings per share includes in the calculation all common shares potentially issuable upon the exercise of stock options, using the "treasury stock method" and the secured convertible debentures, using the "if converted" method.

Diluted earnings per share, using the treasury stock method, assumes outstanding stock options are exercised at the beginning of the period, and the Company's common shares are purchased at the average market price during the period from the funds derived on the exercise of these outstanding options. Stock options with a strike price above the average market price for the period were excluded from the calculation of fully diluted earnings per share as to include them would have increased the earnings per share.

Diluted earnings per share, using the "If converted" method and to the extent the conversion is dilutive, assumes all convertible securities have been converted at the beginning of the period, or at the time of issuance, if later, and any charges of returns on the convertible securities, on an after-tax basis, are removed from net earnings. For the three months ended August 31, 2007, the after-tax interest on the secured convertible debentures has been removed from net earnings and the weighted average number of common shares has been increased by the number of common shares which would have been issued on conversion of the secured convertible debentures, pro rated for the number of days in the period the secured convertible debentures was outstanding. As the interest expense was settled by issuing common shares of the Company, these common shares issued were also excluded from the weighted average number of shares used in the computation of diluted earnings per share.

For the three months ended August 31, 2006, the stock options, warrants to purchase common shares and the secured convertible debentures were not included in the calculation of diluted loss per share because the Company had a loss for that period and to do so would have been anti-dilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

(e) Continuity of contributed surplus

	Three months ended August 31, 2007	Three months ended August 31, 2006 ⁽¹⁾
Balance, beginning of year	\$ 8,525	\$ 7,665
Forfeiture of stock options	18	16
Balance, end of period	\$ 8,543	\$ 7,681

(1) The comparative amounts represent those of Old Lorus—see note 1.

4. Stock-based compensation

	Three months ended August 31, 2007		Three months ended August 31, 2006 ⁽¹⁾	
	Options (in thousands)	Weighted Average exercise price	Options (in thousands)	Weighted average exercise price
Outstanding, beginning of year	12,988	\$ 0.59	\$ 10,300	\$ 0.70
Granted	2,249	0.22	2,417	0.33
Exercised	—	—	(46)	0.30
Forfeited	(503)	0.69	(389)	0.58
Outstanding, end of period	14,734	\$ 0.53	12,282	\$ 0.63

(1) The comparative amounts represent those of Old Lorus—see note 1.

For the three month period ended August 31, 2007 stock compensation expense of \$103 thousand (August 31, 2006 - \$113 thousand) was recognized, representing the amortization applicable to the current period of the estimated fair value of options granted since June 1, 2002.

(b) Fair value assumptions

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of stock options granted during the period:

	Three months ended August 31, 2007	Three months ended August 31, 2006 ⁽¹⁾
Risk-free interest rate	4.75%	4.50%
Expected volatility	80%	80%
Expected life of options	5 years	5 years
Weighted average fair value of options granted or modified during the period	\$0.15	\$0.22

(1) The comparative amounts represent those of Old Lorus—see note 1.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

(c) Continuity of stock options

	Three months ended August 31, 2007	Three months ended August 31, 2006 ⁽¹⁾
Balance, beginning of the year	\$ 4,898	\$ 4,525
Stock option expense	103	113
Forfeiture of stock options	(18)	(24)
Balance, end of period	\$ 4,983	\$ 4,614

(1) The comparative amounts represent those of Old Lorus—see note 1.

5. *Short term investments*

As at August 31, 2007				
(amounts in 000's)	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Held-to-maturity investments:				
Fixed income government investments	\$ 1,525	\$ –	\$ 1,525	3.91%
Corporate instruments	9,627		9,627	3.85 – 4.60%
Held-for-trading investments:				
Corporate instruments	–	2,534	2,534	4.00 – 4.02%
	\$ 11,152	\$ 2,534	\$ 13,686	

As at May 31, 2007⁽¹⁾				
(amounts in 000's)	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Fixed income government investments	\$ 1,549	\$ –	\$ 1,549	3.91%
Corporate instruments	5,716	3,728	9,444	3.89 - 4.11%
	\$ 7,265	\$ 3,728	\$ 10,993	

(1) The comparative amounts represent those of Old Lorus—see note 1.

At August 31, 2007, held to maturity investments are carried at amortized cost. These investments have maturities varying from one to eleven months. Certain corporate instruments have maturities greater than one year, however, the Company has designated these investments as “held-for-trading”, and have classified these investments as short term investments on the balance sheet. These investments are carried at fair value. The change in fair value for the three months ended August 31, 2007 amounted to \$20 thousand and has been charged to the statement of loss and deficit.

At May 31, 2007 the carrying values of fixed income government investments and corporate instruments with maturities less than one year are carried at amortized cost. At May 31, 2007, these investments had maturities of one to ten months. Certain corporate instruments have maturities varying from one to five years and were been classified as long term. These long-term corporate instruments were previously carried at amortized cost. As a result of the adoption of Section 3855, these corporate instruments are now designated as “held-for-trading”, which resulted in an amount of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

\$27 thousand being charged to the opening deficit, being the change in fair value of the instruments prior to May 31, 2007. As this standard was applied retrospectively without restatement, the carrying value of the long-term corporate instruments at May 31, 2007 continue to be disclosed at amortized cost.

6. Secured convertible debentures

The terms of the secured convertible debentures are described in note 12 to the financial statements contained in the Supplemental Financial information of the Company's annual financial statement for the period ended May 31, 2007. The debentures are due on October 6, 2009 and may be converted at the holder's option at any time into common shares of the Company at a conversion price of \$1.00 per share. The lender has the option to demand repayment in the event of default, including the failure to maintain certain covenants, representations and warranties.

Management assesses on a quarterly basis whether or not events during the quarter could be considered an event of default. This assessment was performed and management believes that there has not been an event of default and that, at August 31, 2007; the term of the debt remains unchanged.

7. Income taxes

Income tax recoveries attributable to losses from operations differ from the amounts computed by applying the combined Canadian federal and provincial income tax rates to pre-tax income from operations primarily as a result of the provision of a valuation allowance on net future income tax benefits.

Significant components of the Company's future tax assets are as follows:

	August 31, 2007	May 31, 2007
Non-capital losses carried forward	\$ 784	\$ 24,459
Research and development expenditures	2,204	20,156
Book over tax depreciation	1,065	1,904
Intangible asset	3,855	-
Other	--	309
Future tax assets	7,908	46,828
Valuation allowance	(7,908)	(46,828)
	\$ -	\$ -

Under the Arrangement, numerous steps were undertaken as part of a taxable reorganization. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately \$7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement (note 1(a)). Those tax attributes remaining with Old Lorus are no longer available to the Company.

In assessing the realizable benefit from future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent on the generation of future taxable income during the years in which those temporary differences become deductible. Management considers projected future taxable income, uncertainties related to the industry in which the Company operates and tax planning strategies in making this assessment. Due to the Company's stage of development and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Three months ended August 31, 2007 and 2006

operations, and uncertainties related to the industry in which the Company operates, the tax benefit of the above amounts has been completely offset by a valuation allowance.

The Company has undeducted research and development expenditures, totalling \$9.2 million for federal purposes and \$3.3 million for provincial purposes and these can be carried forward indefinitely. In addition, the Company has non-capital losses carried forward of \$2.3 million for federal purposes and \$2.5 million for provincial purposes. To the extent that the non-capital loss carried forward are not used, they expire as follows:

2008	\$	362
2009		741
2010		141
2015		10
2026		11
2027		4
2028		1,019
	\$	2,288

8. *Subsequent events*

Subsequent to August 31, 2007, the Company extended the option exercise period to those directors not seeking re-election at the annual general meeting and Dr. Wright in relation to his options earned as president and chief executive officer. These transactions result in modification of the terms of the original awards, and the incremental compensation expense relating to the modified options will be accounted for in the second quarter ended November 30, 2007.

Also subsequent to August 31, 2007, the Company received a statement of claim in respect of a dispute with a former employee. It is currently not possible to determine the outcome of such action or the amount of settlement if any, but the Company believes that the suit is without merit and will defend the action vigorously. No provision has been made in the consolidated financial statements.