

TRANSITION THERAPEUTICS INC.
2014 YEAR-END FINANCIAL REPORT

LETTER TO SHAREHOLDERS

Dear Shareholders,

It is with great enthusiasm that I report to you on our fiscal year 2014 which is highlighted by an important acquisition, advancement of our partnered diabetes asset, multiple private placement financings and activities to expand the core strategy of our business.

The acquisition of the neuropsychiatric drug candidate, ELND005, from Perrigo Company plc (“Perrigo”) provides Transition a late stage development program targeting a significant patient population. As Transition holds all development and commercialization rights to ELND005, there is a near-term opportunity for value creation with positive outcomes from the current on-going Phase 2 study. This ELND005 opportunity is paired with Transition’s core strategy of developing assets acquired from Pharma partners. TT401, our diabetes asset partnered to Lilly, has commenced a large Phase 2 study and the Company is working to add one or two more development assets to broaden its pipeline of drug candidates. The ELND005 acquisition has also brought a deeper clinical development team which opens up opportunities for Transition to in-license later stage assets from Pharma partners in the future. Transition is well-financed to execute its overall business strategy as the Company raised approximately US\$43 million through equity offerings during fiscal 2014. The upcoming calendar year of 2015 holds key clinical development milestones for the ELND005 program which have the potential to be transformative for our Company.

ELND005 – NEUROPSYCHIATRIC DRUG CANDIDATE

In February 2014, Transition completed the acquisition of its Irish subsidiary Transition Therapeutics Ireland Limited (“TTIL”) from Perrigo. TTIL’s only asset is the neuropsychiatric drug candidate, ELND005, an oral small molecule compound in multiple clinical studies. Following the acquisition, the ELND005 program was thoroughly reviewed and rationalized to focus on two therapeutic opportunities, the treatment of agitation and aggression associated with Alzheimer’s disease (“AD”) and the treatment of Down syndrome.

The key ELND005 clinical study underway is a Phase 2 clinical study of up to 400 AD subjects who are experiencing moderate levels of agitation and aggression. The development of therapeutics to treat the neuropsychiatric symptoms associated with AD is becoming a central focus of the AD clinical research community. Neuropsychiatric symptoms such as agitation, aggression and others are identified as the leading reasons for the institutionalization of AD patients. For caregivers at home, the burden of managing a loved one who has had become physically and emotionally difficult to handle leads to burnout and ultimately a decision to find an external facility for care. The challenge of managing these AD patients is not solved with institutionalization. As there are no drugs approved to treat agitation and aggression in AD patients, some clinicians turn to the administration of anti-psychotic medications. Unfortunately anti-psychotics carry a “black-box” warning of increased mortality in the elderly. With this current situation, there is great interest in the clinical community for approved drugs with better safety profiles to help these patients.

It is estimated that up to 60% of AD patients will have agitation and aggression over the course of the disease, which would translate to approximately 3 million patients in the United States alone. With the scale of this medical need, the United States Food and Drug Administration (“FDA”) has granted ELND005 “Fast-Track” status for regulatory review as a therapy to treat the neuropsychiatric symptoms of AD.

From a clinical development standpoint, ELND005 is one of the leading drug candidates being developed to address this unmet medical need. Development of ELND005 is supported by previous clinical evidence where mild to moderate AD patients treated with ELND005 had reduced emergence of multiple neuropsychiatric symptoms including depression, anxiety and agitation and aggression. The current Phase 2 clinical study with enrolment up to 400 AD patients is well-powered to provide important data to ultimately support the filing of NDA application in the future, assuming positive results. Transition has employed a clinician-based primary endpoint called the NPI-C to measure patient’s changes in agitation and aggression levels during the study.

LETTER TO SHAREHOLDERS

I can report that study enrolment has increased since Transition's acquisition of the ELND005 program and we remain on target to complete enrolment in the first quarter of calendar 2015. There are currently 65 clinical sites worldwide that are enrolling AD patients. We at Transition are very grateful for the support of our clinical investigators as their dedication in working with and enrolling these patients has been invaluable in the performance of this study.

In addition to the Phase 2 study in agitation and aggression, a pharmacokinetic study in young adults with Down syndrome has also been completed. We expect to report top-line results of the drug candidate's properties in this patient population in the near future.

TT401 (LY2944876) – TYPE 2 DIABETES DRUG CANDIDATE

The fiscal year 2014 also saw important clinical development of diabetes drug candidate TT401 (also known as LY2944876). TT401 is an oxyntomodulin analog that has dual agonist activity of the GLP-1 (Glucagon-Like Peptide-1) and glucagon receptors. At this time, GLP-1 single agonist therapies are a fast-growing therapeutic class to treat type 2 diabetes with more than US\$2 billion in annual sales. GLP-1 single agonist therapies provide type 2 diabetics both blood-glucose regulation and a marginal level of weight loss. The promise of a dual agonist GLP-1 therapy, like TT401, is that type 2 diabetics can have significant weight loss coupled with blood-glucose regulation. As obesity is a growing problem worldwide and is considered a key cause of type 2 diabetes, reducing weight has become the next target in improving the health of those with diabetes.

Following our partner Lilly's exercise of its option to acquire the development and commercialization rights to TT401, there has been a consistent and purposeful advancement of this drug candidate. Lilly announced the start of a Phase 2 study enrolling up to 375 type 2 diabetes subjects in May 2014. This study will evaluate four dose arms of TT401, a placebo arm, and an active comparator arm in the form of once-weekly exenatide. There will be a 12-week blinded treatment period, where neither the participant nor the investigator will know which treatment each individual is assigned. Thereafter follows a 12-week period (weeks 13-24) where participants and the investigator will know which treatment they are assigned to. The main efficacy outcome measures will be the change in HbA1c (a measure of blood-glucose levels) at week 12 and 24 and change in body weight over the course of the study. The inclusion of the active comparator arm in this study will be a benchmark to assess the additive benefit of the dual agonist therapy of TT401.

GROWTH OF THE DEVELOPMENT PIPELINE

The presence of two late-stage clinical assets targeting large patient populations has not diminished or distracted management from continuing to pursue a prudent strategy of parallel development of multiple drug candidates. With this in mind, Transition has sought to add one or two additional development programs through in-licensing. We are seeking new pipeline candidates with evidence, clinical or otherwise, of therapeutic activity that we can quickly advance further in clinical development. This strategy also employs arrangements with potential partners to cooperate in de-risking the in-licensed candidate prior to the formal execution of a licensing agreement. In this way, new drug candidates have an appropriate risk-to-reward profile before the full Transition team is engaged in their development.

LOOKING AHEAD

Next year, with its clinical milestones, promises to be an important year in the growth of Transition. The results from the ELND005 Phase 2 clinical study in agitation and aggression in AD are expected in mid- calendar year 2015. With this study enrolling up to 400 patients, it will have the size and statistical power to demonstrate the effects on ELND005 in reducing agitation and aggression in AD patients. Adding to that, Lilly will continue performing a 375 subject Phase 2 study TT401 in type 2 diabetes. The design of this study will provide guidance on the potential commercial benefit of

TT401 as it will be benchmarked against a marketed GLP-1 single-agonist therapy. And finally, Transition will look to in-license one or two additional programs to broaden the company development pipeline.

In 2014, we completed two private placements and an equity financing with Perrigo as part of the ELND005 transaction. These activities raised US\$43 million for Transition and with the exercise of associated share warrants could add another US\$24 million for the Company. These funds will provide Transition sufficient cash to execute its business strategy through the next major clinical development milestone for ELND005 and TT401. Transition's large investors, Board members and management principally provided the funding for our two private placement financings. This on-going strong support from our shareholders and the Company's Board and management has been fundamental as Transition looks to advance to its upcoming clinical milestones.

I would like to take this opportunity to thank our employees and our Board of Directors and scientific advisors for their contribution. We look forward to reporting on these events over the next year and thank our shareholders for their commitment, continued support and confidence.

A handwritten signature in black ink, appearing to read 'Tony Cruz', with a long horizontal stroke extending to the left.

Tony Cruz
Chairman and Chief Executive Officer
Transition Therapeutics Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion and analysis of the operating results and financial position of Transition Therapeutics Inc. for the year ended June 30, 2014. This document should be read in conjunction with the Company's audited consolidated financial statements and the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards (IFRS). This Management's Discussion and Analysis ("MD&A") provides a review of the performance of the Company for the year ended June 30, 2014 as compared to the year ended June 30, 2013. This review was performed by management with information available as of September 19, 2014.

Where "we", "us", "our", "Transition" or the "Company" is used, it is referring to Transition Therapeutics Inc. and its wholly-owned subsidiaries, unless otherwise indicated. All amounts are in Canadian dollars, unless otherwise indicated.

Additional information relating to the Company, including the Company's most recently filed Annual Information Form, can be found on SEDAR at www.sedar.com.

CAUTION REGARDING FORWARD LOOKING STATEMENTS

This MD&A contains certain forward looking statements within the meaning of applicable securities laws. Forward looking information typically contains statements with words such as "anticipate", "believe", "expect", "plan", "estimate", "intend", "may" or similar words suggesting future outcomes. Forward-looking statements in this MD&A include, but are not limited to statements with respect to: the clinical study phases of the Company's product candidates which the Company expects to complete in fiscal 2015 and beyond; the ability of the Company's business model to maximize shareholder returns; the potential for ELND005 to slow the progression of Alzheimer's disease and improve symptoms; the potential for ELND005 to be effective for the treatment of agitation and or aggression in patients with Alzheimer's disease; the potential for ELND005 to be effective for the treatment of Down syndrome; the timing and manner of future clinical development of ELND005; the global population size of those affected by Alzheimer's disease; the demand for a product that can slow or reverse the progression of Alzheimer's disease; the demand for a product that can reduce the emergence of neuropsychiatric symptoms like depression, anxiety, agitation and aggression in Alzheimer's disease; the potential clinical benefit of ELND005 in the treatment of other disease indications; the development of TT401 and the series of preclinical compounds in-licensed from Eli Lilly and Company ("Lilly") and their potential benefit in type 2 diabetes patients; the timing and manner of future clinical development of TT401 performed by Lilly; the engagement of third party manufacturers to produce the Company's drug substances and products; the potential future in-licensing of additional drug candidates to expand the development pipeline; the intention of the Company to make collaborative arrangements for the marketing and distribution of its products and the impact of human capital on the growth and success of the Company.

This forward-looking information is subject to various risks and uncertainties, including those discussed below, that could cause actual results and experience to differ materially from the anticipated results or other expectations expressed. Readers are cautioned not to place undue reliance on this forward-looking information, which is provided as of the date of this MD&A unless otherwise stated, and the Company will not undertake any obligation to publicly update or revise any forward-looking information, whether as a result of new information, future events, or otherwise, except as required by securities laws.

Some of the assumptions, risks and factors which could cause future outcomes to differ materially from those set forth in the forward-looking information include, but are not limited to: (i) the assumption that the Company will be able to obtain sufficient and suitable financing to support operations, clinical trials and commercialization of products, (ii) the risk that the Company may not be able to capitalize on partnering and acquisition opportunities, (iii) the assumption that the Company will obtain favourable clinical trial results in the expected timeframe, (iv) the assumption that the Company will be able to adequately protect proprietary information and technology from competitors, (v) the risks

relating to the uncertainties of the regulatory approval process, (vi) the impact of competitive products and pricing and the assumption that the Company will be able to compete in the targeted markets, and (vii) the risk that the Company may be unable to retain key personnel or maintain third party relationships, including relationships with key collaborators.

By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections or other forward-looking statements will not occur. Prospective investors should carefully consider the information contained under the heading "RISKS AND UNCERTAINTIES" as described in the MD&A.

OVERVIEW

Transition is a biopharmaceutical development company, advancing novel therapeutics for CNS and metabolic disease indications. The Company's wholly-owned subsidiary, Transition Therapeutics Ireland Limited is developing CNS drug candidate ELND005 for the treatment of Alzheimer's disease and Down syndrome. Transition's lead metabolic drug candidate is TT401 for the treatment of type 2 diabetes and accompanying obesity.

Highlights for the Company during the year ended June 30, 2014 and up to the date of this MD&A include the following:

ELND005:

- **April 7, 2014 - Transition provided a clinical development update on Transition Therapeutics Ireland Limited's neuropsychiatric drug candidate, ELND005. The Company announced the decision to focus ELND005 development on the completion of current Phase 2 clinical studies in Agitation and Aggression in Alzheimer's disease and a Phase 2a study in Down syndrome.** A decision was also made to discontinue the clinical study of bipolar subjects following a commercial assessment of the size and length of the bipolar study, and costs and timelines for its completion. This decision was not based on any analysis of efficacy data and there were no adverse safety findings that contributed to this decision;
- **February 28, 2014 - Transition announced the acquisition of an Irish domiciled company, the holder of all the development and commercialization rights of neuropsychiatric drug candidate, ELND005.** Going forward, Transition's wholly owned subsidiary, Transition Therapeutics Ireland Limited, will be responsible for all future development and commercialization activities of the ELND005 drug candidate. In parallel with this acquisition, Perrigo Company plc ("Perrigo") has invested US\$15 million and received 2,255,640 Transition common shares representing approximately a 7% ownership stake in Transition. Perrigo will also be eligible to receive up to US\$40 million in approval and commercial milestone payments and a 6.5% royalty on net sales of ELND005 products and sublicense fees received;
- **December 18, 2013 - Perrigo completed its acquisition of Elan Pharmaceuticals and all its subsidiaries.** With this acquisition, Perrigo acquired all the rights and obligations of Elan under the collaboration agreement with Waratah, a wholly-owned subsidiary, for the development and commercialization of ELND005;
- **September 4, 2013 - Transition announced that their licensing partner Elan had dosed the first patient in a Phase 2a clinical study of ELND005 in Down syndrome.**
- **July 17, 2013 - Transition announced that the US Food and Drug Administration ("FDA") has granted Fast Track Designation to the development program for ELND005 which was submitted for the treatment of Neuropsychiatric Symptoms ("NPS") in Alzheimer's disease ("AD").** The FDA concluded that the development program for ELND005 for the treatment of NPS in AD meets their criteria for Fast Track Designation.

MANAGEMENT'S DISCUSSION AND ANALYSIS

TT401:

- **May 15, 2014 - Transition announced the dosing of the first patient in a Phase 2 clinical study of TT401 (LY2944876), a drug candidate for the treatment of type 2 diabetes.** The study is expected to enroll up to 375 type 2 diabetes subjects and will be performed by Transition's development partner, Eli Lilly and Company ("Lilly"). The objectives of the study will be to evaluate the safety and effectiveness of TT401 compared to once-weekly exenatide extended release and placebo;
- **April 7, 2014 - Transition provided a clinical development update and announced that a Phase 2 study of TT401 is in the final preparation stage with dosing expected to commence in calendar Q2 2014.**

Corporate Developments:

- **June 23, 2014 - Transition announced the closing of the private placement involving Jack W. Schuler, Larry N. Feinberg, Oracle Investment Management, certain Transition Board members, management and other existing shareholders of US\$17 million by purchasing 3,195,487 units of the Company at a price of US\$5.32 per unit;**
- **February 28, 2014 - In parallel with the re-acquisition of the ELND005 rights, Transition announced that Perrigo has invested US\$15 million and received 2,255,640 Transition common shares representing approximately a 7% ownership stake in Transition;**
- **August 15, 2013 - Transition announced the closing of the private placement involving Jack W. Schuler, Larry N. Feinberg, Oracle Investment Management, certain Transition Board members, management and other existing shareholders of US\$11 million by purchasing 2,625,300 units of the Company at a price of US\$4.19 per unit.**

STRATEGIC COLLABORATIONS

Perrigo

In 2006, Transition exclusively licensed the ELND005 technology to Elan for worldwide development and commercialization. Following amendment of that agreement in 2010, Elan held all development and commercialization rights to ELND005 and Transition became eligible to receive milestone and royalty payments with the successful advancement of ELND005. Transition has received US\$40 million from Elan in upfront and achieved milestone payments. Perrigo acquired Elan in December 2013, including all Elan's rights and obligations to the development of ELND005.

On February 28, 2014, Transition announced that after a series of transactions, Perrigo had transferred all of its ELND005 rights and assets under the collaboration agreement to the Company's wholly owned subsidiary, Transition Therapeutics Ireland Limited. In parallel with this acquisition, Perrigo invested US\$15 million and received 2,255,640 Transition common shares representing approximately a 7% ownership stake in Transition. Perrigo will also be eligible to receive up to US\$40 million in approval and commercial milestone payments and a 6.5% royalty on net sales of ELND005 products and sublicense fees received. Going forward, Transition Therapeutics Ireland Limited will be responsible for all future development and commercialization activities of the ELND005 drug candidate.

Lilly

(i) Diabetes

On March 3, 2010, Transition and Lilly entered into a licensing and collaboration agreement granting Transition the rights to a series of preclinical compounds in the area of diabetes. Under the licensing and collaboration agreement, Transition received exclusive worldwide rights to develop and potentially commercialize a class of compounds that, in preclinical models, showed potential to provide glycemic control and other beneficial effects including weight loss.

Under the terms of the agreement, Lilly received an up-front payment of \$1,055,900 (US\$1 million) which has been capitalized as a license acquired from Lilly and is being amortized over 20 years which represents the estimated life of the underlying compounds and patents.

In June 2013, Lilly exercised its option and assumed all development and commercialization rights to type 2 diabetes drug candidate TT401. In conjunction with this assumption of rights, Transition received a US\$7 million milestone payment. Lilly has assumed all costs and will perform all future development and commercialization activities of TT401, and Transition will pay US\$14 million to Lilly in three separate installments during the Phase 2 clinical study; the first installment of US\$6 million has been paid subsequent to the year ended June 30, 2014 when the study achieved 20% patient enrollment. In return, Transition is eligible to receive up to approximately US\$240 million in additional milestone payments. Transition will also be eligible to receive a double-digit royalty on sales of TT401 products and a low single digit royalty on related compounds.

(ii) Osteoarthritis Pain

On July 23, 2013, Transition announced the exclusive licensing of worldwide rights to a novel small molecule transcriptional regulator (“TT601”) from Lilly for the treatment of osteoarthritis pain. On April 7, 2014, the Company announced there would be no further development of TT601. This decision was made after expanded toxicology study data and regulatory interactions revealed the development plan would be restricted and timelines delayed. Under the terms of the agreement with Lilly, the rights to TT601 have been returned to Lilly and the Company has no further funding obligations to Lilly for the development of TT601.

PROGRAMS

Transition is focused on developing innovative therapies in several distinct areas of opportunity. Transition’s vision is to build a company that has a strong foundation for growth based on multiple technologies and product opportunities, which reduces risk and enhances return. The Company’s technologies are as follows:

Alzheimer’s Disease:

Alzheimer’s disease is a progressive brain disorder that gradually destroys a person’s memory and ability to learn, reason, make judgments, communicate and carry out daily activities. As Alzheimer’s disease progresses, individuals may also experience changes in personality and behavior, such as anxiety, suspiciousness or agitation, as well as delusions or hallucinations. Approximately 90% of Alzheimer’s disease patients develop neuropsychiatric symptoms, and up to 60% develop agitation/aggression over the course of their disease. Agitation/aggression are among the most disruptive neuropsychiatric symptoms in Alzheimer’s disease and are associated with increased morbidity and caregiver burden.

The disease mainly affects individuals over age 65 and it is estimated over 18 million people are suffering from Alzheimer’s disease worldwide. In the U.S., Alzheimer’s disease is the sixth leading cause of death and current direct/indirect costs of caring for an estimated 5.4 million Alzheimer’s disease patients are at least US\$100 billion annually.

Current U.S. Food and Drug Administration approved Alzheimer’s disease medications may temporarily delay memory decline for some individuals, but none of the currently approved drugs are known to stop the underlying degeneration of brain cells. Certain drugs approved to treat other illnesses may sometimes help with the emotional and behavioral symptoms of Alzheimer’s disease. With an aging population, there is a great need for therapies to address Alzheimer’s disease patient’s neuropsychiatric symptoms and declines in cognitive ability.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Down Syndrome:

Down syndrome (DS, Trisomy 21), caused by an extra copy of chromosome 21, is the most common genetic form of intellectual disability with a prevalence of approximately 1 in 700 live births in the US. Children with DS exhibit developmental delay and various degrees of intellectual disability, while adults are at increased risk of Alzheimer's dementia. There are currently no drugs approved for the treatment of cognitive dysfunction in DS.

Excess activity of genes on chromosome 21, such as amyloid precursor protein (APP) and sodium-myo-inositol active transporter (SMIT), are thought to play a role in the cognitive dysfunction of DS. Life-long exposure to increased amyloid and myo-inositol levels in the brain are thought to lead to synaptic dysfunction and cognitive disability. ELND005 may have the potential to improve cognition in DS by decreasing amyloid levels and regulating myo-inositol-dependent neuronal signaling.

CLINICAL DEVELOPMENT UPDATE

ELND005 for Neuropsychiatric Diseases

Transition Therapeutics Ireland Limited is developing neuropsychiatric drug candidate ELND005, (scyllo-inositol). ELND005 is an orally bioavailable small molecule that is being investigated for multiple neuropsychiatric indications on the basis of its proposed dual mechanism of action, which includes β -amyloid anti-aggregation and regulation of brain myo-inositol levels. An extensive clinical program of Phase 1 and Phase 2 studies have been completed with ELND005 to support clinical development. The Phase 2 study (ELND005-AD201) which evaluated ELND005 in more than 350 mild to moderate AD patients was published in the peer-reviewed journal, *Neurology*. The *Neurology* article was entitled "A Phase 2 randomized trial of ELND005, scyllo-inositol, in mild-moderate Alzheimer's disease".

Currently, there are two Phase 2 clinical studies of ELND005 being performed:

(a) Agitation and Aggression in Alzheimer's Disease

On November 27, 2012, the first patient was enrolled in a Phase 2 clinical trial of ELND005 for the treatment of agitation/aggression in patients with mild to severe Alzheimer's disease. The objectives of the study are to evaluate the efficacy, safety and tolerability of ELND005 over 12 weeks of treatment in patients with mild to severe AD, who are experiencing at least moderate levels of agitation/aggression. This ongoing clinical study (AG201) is called the "Harmony AD" study (www.harmonyadstudy.com) and has a projected enrollment of up to 400 subjects. Enrollment is expected to be completed by the first quarter of calendar 2015 with results from the study expected around the middle of the calendar year. A safety extension study (Study "AG251") is ongoing and is enrolling subjects who have completed the placebo-controlled "HarmonyAD" study. To date, the large majority of subjects completing the "HarmonyAD" study are participating in the AG251 extension study.

(b) Down Syndrome

On September 4, 2013, Transition announced the first patient was dosed in a Phase 2a study of ELND005 in Down syndrome. This study evaluates the safety, pharmacokinetics of ELND005 and includes selected cognitive and behavioral measures over a one-month treatment period. The Phase 2a study of ELND005 in young adult subjects with Down Syndrome has completed enrollment and the data from this study are expected to be available before the end of calendar 2014. Following the completion of this study, depending on the data and the advice from regulatory agencies and experts in the field, the next step in development would be a larger Phase 2b study in Down syndrome subjects.

The ELND005 technology is claimed in multiple issued patents and pending patent applications in many jurisdictions throughout the world.

Expenditures for the ELND005 Program

On February 28, 2014, Transition announced that after a series of transactions, Perrigo has transferred all of its ELND005 rights and assets to the Company's wholly owned subsidiary, Transition Therapeutics Ireland Limited. As a result, effective March 1, 2014, Transition Therapeutics Ireland Limited is responsible for all future development and commercialization activities of the ELND005 drug candidate. During the four month period ended June 30, 2014, the Company incurred approximately \$11,800,000 in clinical trial and development costs relating to ELND005. Prior to the acquisition, Transition was not required to fund the development or commercialization of ELND005 and accordingly, development costs were nil during fiscal 2013.

TT401 / TT402

Development of TT401 and TT402 for Diabetes

Diabetes is a disease in which the body does not produce or properly use insulin. Insulin is a hormone released from islet cells located in the pancreas that is needed to convert sugar, starches and other food into energy needed for daily life. There are two primary forms of diabetes; type 1 diabetes and type 2 diabetes.

Type 2 diabetes usually begins as insulin resistance, a disorder in which the cells do not use insulin properly. As the need for insulin increases, the pancreas gradually loses its ability to produce it. Current treatments for type 2 diabetes include lifestyle changes, oral medications, incretin therapy and insulin therapy. Type 2 diabetes accounts for about 90-95% of all diagnosed cases of diabetes.

Clinical Development of TT401 (LY2944876)

On March 3, 2010, Transition announced that it had acquired the exclusive worldwide rights to develop and potentially commercialize a series of preclinical compounds from Lilly in the area of diabetes. In preclinical diabetes models, these compounds showed potential to provide glycemic control and other beneficial effects including weight loss.

On June 18, 2012, Transition announced the results of the Phase 1 clinical study of type 2 diabetes drug candidate, TT401. The Phase 1, double-blind, placebo-controlled randomized study enrolled 48 non-diabetic obese subjects in six cohorts evaluating six escalating subcutaneous single doses of TT401. TT401 demonstrated an acceptable safety and tolerability profile in non-diabetic obese subjects in the study. TT401 exhibited the expected pharmacological effect on glucose and pharmacodynamic biomarkers at doses that were safe and tolerable. The pharmacokinetic profile, assessed over 28 days, demonstrated a half-life consistent with once-weekly dosing.

On April 30, 2013, Transition announced the results of a five-week proof of concept clinical study of TT401 in type 2 diabetes and obese non-diabetic subjects. The study enrolled diabetic patients at five dosing levels and non-diabetic obese patients at one dose level. All dosing cohorts received five doses over a five week period. Diabetic patients were on stable doses of metformin.

At the end of the treatment period, TT401-treated patients in the 3 highest dose groups experienced statistically significant reductions in mean fasting plasma glucose relative to placebo. Statistically significant mean body weight reduction relative to baseline occurred in the three highest dose groups. A similar reduction in body weight was also observed in the obese non-diabetic cohort. TT401 demonstrated an acceptable safety and tolerability profile at all doses evaluated in diabetic and non-diabetic obese subjects. The most common adverse event noted in the study was decreased appetite. Some subjects in the highest three dose groups experienced mild nausea and vomiting, which are consistent with studies of other GLP-1 agonist drug candidates. The pharmacokinetic profile, assessed over the five week study, demonstrated a half-life consistent with once-weekly dosing.

MANAGEMENT'S DISCUSSION AND ANALYSIS

On June 17, 2013, Lilly exercised its option to assume all development and commercialization rights to type 2 diabetes drug candidate TT401. In conjunction with this assumption of rights, Transition received a US\$7 million milestone payment. Lilly and Transition have amended their agreement to address future development of TT401 and associated financial arrangements. Lilly has assumed all costs and will perform all future development and commercialization activities of TT401. In May, 2014, Transition announced the dosing of the first patient in a Phase 2 clinical study of TT401. The study is expected to enroll up to 375 type 2 diabetes subjects and will be performed by Transition's development partner Lilly. The objectives of the study will be to evaluate the safety and effectiveness of TT401 compared to once-weekly exenatide extended release and placebo.

Transition will contribute payment of US\$14 million to Lilly in three separate installments during the Phase 2 clinical study. The first installment of US\$6 million has been paid subsequent to the year ended June 30, 2014 when the study achieved 20% patient enrollment.

Expenditures for the TT-401/402 Program

During the years ended June 30, 2014 and 2013, the Company incurred direct research and development costs for this program as follows:

| TT-401/402 Program⁽¹⁾ | Fiscal 2014 \$ | Fiscal 2013 \$ |
|---|---------------------------|---------------------------|
| Pre-clinical studies | 7,488 | 1,380,015 |
| Clinical studies | 87,379 | 2,012,758 |
| Manufacturing | (37,419) | 1,141,844 |
| Other direct research | 37,803 | 169,407 |
| TOTAL | 95,251 | 4,704,024 |

⁽¹⁾ These costs are direct research and development costs only and do not include patent costs, investment tax credits, salaries and benefits, amortization of intangible assets or an allocation of Company overhead.

TT-601 for Osteoarthritis Pain

Clinical Development of TT-601

On April 7, 2014, the Company announced there would be no further development of TT601. This decision was made after expanded toxicology study data and regulatory interactions revealed the development plan would be restricted and timelines delayed. Under the terms of the agreement with Lilly, the rights to TT601 have been returned to Lilly and the Company has no further funding obligations to Lilly for the development of TT601.

Expenditures for the TT-601 Program

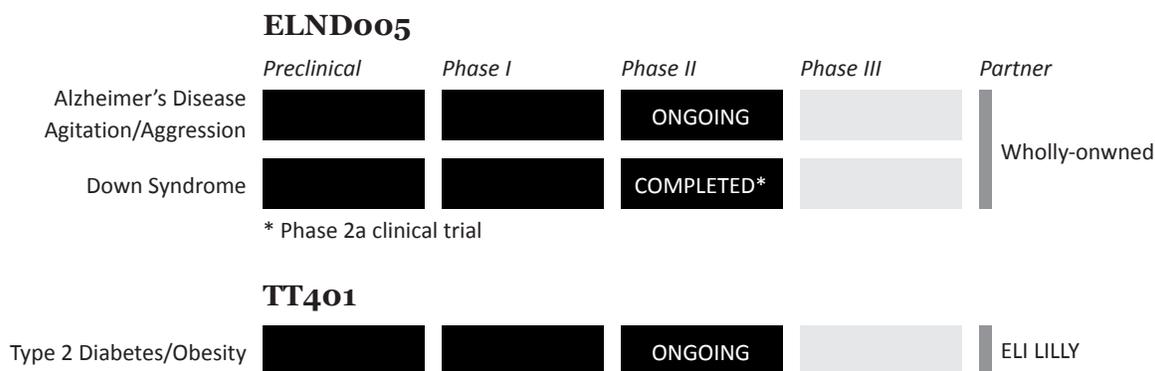
During the years ended June 30, 2014 and 2013, the Company incurred direct research and development costs for this program as follows:

| TT-601 Program ⁽¹⁾ | Fiscal 2014 \$ | Fiscal 2013 \$ |
|-------------------------------|-------------------|-------------------|
| Pre-clinical studies | 801,094 | - |
| Clinical studies | 72,205 | - |
| Manufacturing | 373,013 | - |
| Other direct research | 81,401 | - |
| TOTAL | 1,327,713 | - |

⁽¹⁾ These costs are direct research and development costs only and do not include patent costs, investment tax credits, salaries and benefits, amortization of intangible assets or an allocation of Company overhead.

The Next Steps

Transition's goal for its programs is to achieve product approval and ultimately significant revenues or royalties. To achieve product approval, the Company and or its partners, must successfully complete clinical trials and achieve regulatory approval. The stages of development of the Company's technologies are illustrated below:



OVERALL PERFORMANCE

During the year ended June 30, 2014, the Company recorded a net loss of \$21,782,255 (\$0.72 loss per common share) compared to net income of \$23,297 (\$0.00 income per common share) for the year ended June 30, 2013.

During the fiscal year ended June 30, 2014, the Company reported an increase in net loss of \$21,805,552 compared to the fiscal year ending June 30, 2013. The increase in net loss is largely attributed to the decrease in revenue recognized during the current year. In fiscal 2013 the Company recognized \$17,933,500 as revenue which is comprised of the milestone payment of \$10,815,200 (US\$11,000,000) received from Elan upon their commencement of the next ELND005 clinical trial and the milestone payment of \$7,118,300 (US\$7,000,000) received from Lilly upon exercising its option to assume all development and commercialization rights to type 2 diabetes drug candidate TT401. The increase in net loss is also attributed to increased research and development costs relating to the ELND005 asset, the settlement of a pre-existing relationship recognized in connection with the re-acquisition of the ELND005, increased general and administration expenses and decreased foreign exchange gains. The increase in net loss has been partially offset by the change in fair value of contingent consideration payable recognized during the year.

At June 30, 2014, the Company's cash and cash equivalents and short term investments were \$60,271,566. During fiscal 2014, the Company raised gross proceeds of approximately US\$43 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

- (i) on August 15, 2013, the Company announced the closing of its private placement financing issuing 2,625,300 units of the Company to existing shareholders, board members and management at a price of US\$4.19 per unit, raising gross proceeds of \$11,439,000 (US\$11.0 million). Each unit consisted of (i) one common share, (ii) 0.325 Common Share purchase warrant with a purchase price of US\$4.60 per whole warrant and (iii) 0.4 Common Share purchase warrant with a purchase price of US\$6.50 per whole warrant. The Company incurred total share issuance costs of \$521,000, resulting in net cash proceeds of approximately \$10,918,000. If and when all of the warrants are exercised, the Company will realize an additional US\$10.7 million in proceeds;
- (ii) on February 28, 2014, the Company issued 2,255,640 common shares to a subsidiary of Perrigo for gross proceeds of \$16,422,000 (US\$15.0 million). The Company incurred total share issuance costs of \$59,000, resulting in net cash proceeds of approximately \$16,363,000; and
- (iii) on June 23, 2014, the Company announced the closing of its private placement financing issuing 3,195,487 units of the Company to existing shareholders, board members and management at a price of US\$5.32 per unit, raising gross proceeds of \$18,319,000 (US\$17.0 million). Each unit consisted of one common share and 0.61 Common Share purchase warrant with a purchase price of US\$7.10 per whole warrant. The Company incurred total share issuance costs of \$106,000, resulting in net cash proceeds of approximately \$18,213,000. If and when all of the warrants are exercised, the Company will realize an additional US\$13.8 million in proceeds.

In light of the financing initiatives undertaken during fiscal 2014, the Company's current cash projection indicates that the current cash resources should enable the Company to execute its core business plan and meet its projected cash requirements beyond the next 12 months

SELECTED ANNUAL INFORMATION

The following table is a summary of selected financial information from the audited consolidated financial statements of the Company for each of the three most recently completed financial years:

| | June 30, 2014 | June 30, 2013 | June 30, 2012 |
|--|---------------|---------------|---------------|
| | \$ | \$ | \$ |
| Revenue | - | 17,933,500 | - |
| Net income (loss) ⁽¹⁾ | (21,782,255) | 23,297 | (12,269,845) |
| Basic and diluted net income (loss) per common share | (0.72) | 0 | (0.48) |
| Total assets | 68,907,236 | 37,807,955 | 37,093,030 |
| Total long-term liabilities ⁽²⁾ | 3,849,718 | 1,457,821 | 1,469,253 |
| Cash dividends declared per share | - | - | - |

⁽¹⁾ Net income (loss) before discontinued operations and extraordinary items was equivalent to the net income (loss) for such periods.

⁽²⁾ Total long-term liabilities is comprised of contingent consideration payable and leasehold inducement as set forth in the Company's audited consolidated financial statements for the years ended June 30, 2014 and 2013.

ANNUAL RESULTS – YEAR ENDED JUNE 30, 2014 COMPARED TO YEAR ENDED JUNE 30, 2013

RESULTS OF OPERATIONS

Revenue

Revenue is nil in the year ended June 30, 2014 compared to \$17,933,500 for the year ended June 30, 2013.

In fiscal 2013 the Company recognized \$17,933,500 as revenue which is comprised of the milestone payment of \$10,815,200 (US\$11,000,000) received from Elan upon their commencement of the next ELND005 clinical trial and the milestone payment of \$7,118,300 (US\$7 million) received from Lilly upon exercising its option to assume all development and commercialization rights to type 2 diabetes drug candidate TT401.

Research and Development

Research and development expenses increased \$8,504,513 or 96% from \$8,862,872 for the fiscal year ended June 30, 2013 to \$17,367,385 for the fiscal year ended June 30, 2014.

The increases in research and development expenses are primarily due to increases in clinical development costs related to the re-acquired rights to the drug candidate ELND005 as well as the costs associated with the pre-clinical research on TT601. The increase in research and development costs have been partially offset by decreases in clinical development costs associated with diabetes drug candidate TT401/TT402 as well as decreased amortization resulting from the write off of the TT301/302 technology.

The Company anticipates that research and development expenses will increase significantly during fiscal 2015 as the Company continues to fund the clinical development of the ongoing Phase 2 clinical trial of ELND005 in agitation and aggression in Alzheimer's disease and will also pay US\$14 million to Lilly in three separate installments to help fund the ongoing Phase 2 clinical study of diabetes drug candidate TT401.

General and Administrative

General and administrative expenses increased by \$1,168,782 or 33% from \$3,557,792 for the fiscal year ended June 30, 2013 to \$4,726,574 for the fiscal year ended June 30, 2014.

The increases in general and administrative expenses are primarily due to increases in legal and professional fees as well as increased business and corporate development activities.

The Company anticipates that general and administrative expenses will remain relatively consistent during fiscal 2015.

Impairment of Intangible Assets

Impairment of intangible assets is nil for the year ended June 30, 2014 compared to \$6,545,821 for the year ended June 30, 2013.

During fiscal 2013, the Company decided to no longer develop TT301 and TT302, the compounds acquired from NMX. Accordingly, the Company recognized an impairment loss of \$6,545,821.

Settlement of a Pre-existing Relationship

During the year ended June 30, 2014, the Company recognized an expense of \$3,096,186 as a settlement of a pre-existing relationship relating to the collaboration agreement with Elan. The Company did not recognize a settlement during the comparative year ended June 30, 2013.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Change in Fair Value of Contingent Consideration Payable

The contingent consideration is required to be measured as a financial liability at fair value and re-measured at each reporting date. On February 28, 2014, the Company became responsible for the development of ELND005 and accordingly has re-evaluated the development program timelines and adjusted the estimate relating to the timing of the milestone payments. Accordingly, the Company has recognized a change in fair value of contingent consideration payable of \$2,911,218 during the year ended June 30, 2014. There was no change in fair value recognized during the comparative period ended June 30, 2013.

SUMMARY OF QUARTERLY RESULTS

The following table is a summary of selected quarterly consolidated financial information of the Company for each of the eight most recently completed quarters ending at June 30, 2014.

| | First Quarter \$ | Second Quarter \$ | Third Quarter \$ | Fourth Quarter \$ | Total \$ |
|--|---------------------|----------------------|---------------------|----------------------|--------------|
| 2014 | | | | | |
| Revenue | - | - | - | - | - |
| Net income (loss) ⁽¹⁾ | (2,331,186) | (1,253,772) | (5,067,292) | (13,130,005) | (21,782,255) |
| Basic and diluted net income (loss) per common share | (0.08) | (0.04) | (0.17) | (0.43) | (0.72) |
| 2013 | | | | | |
| Revenue | 10,815,200 | - | - | 7,118,300 | 17,933,500 |
| Net income (loss) ⁽¹⁾ | 7,736,046 | (2,754,534) | (2,903,331) | (2,054,884) | 23,297 |
| Basic and diluted net income (loss) per common share | 0.29 | (0.10) | (0.11) | (0.08) | - |

⁽¹⁾ Net income (loss) before discontinued operations was equivalent to the net income (loss) for such periods.

The fluctuations of Transition's quarterly results are primarily due to the recognition of up-front and licensing fees relating to the Elan and Lilly agreements, recognition of an impairment loss relating to the TT301/TT302 technology, and changes in: activity levels of the clinical trials being performed by the Company; foreign exchange gains and losses; and business and corporate development costs.

FOURTH QUARTER RESULTS

The following table is a summary of selected information for the three month periods ended June 30, 2014 and June 30, 2013:

| | 2014 \$ | 2013 \$ |
|---------------------------------|------------|------------|
| Revenue – Licensing fees | - | 7,118,300 |
| Research and development, net | 10,464,484 | 2,286,536 |
| General and administrative | 1,673,616 | 1,020,593 |
| Impairment of intangible assets | - | 6,545,821 |
| Interest income | 56,250 | 38,761 |
| Net loss | 13,130,005 | 2,054,884 |

Review of Operations

For the three month period ended June 30, 2014, the Company's net loss increased by \$11,051,093 or 538% to \$13,130,005 compared to \$2,054,884 for the same period in fiscal 2013.

Revenue was nil and \$7,118,300 for the three month period ending June 30, 2014 and 2013, respectively. During the fourth quarter of fiscal 2013, Lilly exercised its option to assume all development and commercialization rights to type 2 diabetes drug candidate TT401. Transition received \$7,118,300 (US\$7 million) milestone payment, which has been recognized as revenue during the fourth quarter of fiscal 2013.

Research and development expenses increased by \$8,177,948 or 358% to \$10,464,484 compared to \$2,286,536 for the same period in fiscal 2013. This increase was primarily due to an increase in clinical development costs related to the re-acquired rights to the drug candidate ELND005 and pre-clinical research on TT601, which has been partially offset by decreases in clinical development costs associated with diabetes drug candidate TT401/TT402 as well as decreased amortization resulting from the write off of the TT301/302 technology.

General and administrative expenses increased by \$653,023 or 64% to \$1,673,616 from \$1,020,593 for the same period in fiscal 2013. This increase was primarily due to increases in legal and professional fees as well as increased business and corporate development activities.

Impairment of intangible assets was nil for the three month ending June 30, 2014 and \$6,545,821 for the comparable period ended June 30, 2013. During the three-month period ended June 30, 2013, the Company assessed the TT301/302 compounds for impairment and determined that the recoverable amount of the compounds was nil. Accordingly, the Company has recognized an impairment loss of \$6,545,821 during the fourth quarter of fiscal 2013.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results can differ from those estimates. We have identified the following areas which we believe require management's most subjective estimates and judgments, often requiring the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods.

(a) Estimates

Valuation and Amortization of Intangible Assets

The Company's intangible assets are comprised of purchased or licensed pharmaceutical compounds, technology and patents. The costs of the Company's intangible assets are amortized over the estimated useful life of 20 years. Factors considered in estimating the useful life of the intangible asset include the expected use of the asset by the Company, legal, regulatory and contractual provisions that may limit the useful life, the effects of competition and other economic factors, and the level of expenditures required to obtain the expected future cash flows from the intangible asset. The Company re-evaluates the useful life when there has been a change in these factors. In light of the series of agreements the Company entered into with Perrigo relating to the ELND005 technology, management reviewed the estimate of the remaining useful life of the ELND005 technology and extended it to 12 years. Accordingly, the change in estimate resulted in a decrease in amortization expense of \$108,774 being recognized during the year ended June 30, 2014.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company assesses its intangible assets for recoverability whenever indicators of impairment exist. When the carrying value of an asset is greater than its recoverable amount, which is the higher of its value in use or fair value less costs to sell, an impairment loss is recognized. An impairment loss of \$6,545,821 was recognized in the fourth quarter of fiscal 2013 to write off the intangible asset related to TT301 as a result of management's decision to terminate the program.

Valuation of Contingent Consideration Payable

The contingent consideration is measured at fair value based on level 3 inputs. The contingent consideration is not based on observable inputs and is measured using a discounted cash flow analysis of expected payments in future periods. The significant estimates used in the fair value calculations are as follows:

- (a) Management has estimated the timing of the milestone payments based on current expectations and plans for the development of ELND005. The milestone payments are assigned a probability based on industry statistics for the successful development of pharmaceutical products including regulatory approval and achievement of revenue targets. An increase of 10% applied to the probability assumptions, with all other variables held constant, will increase the contingent consideration payable by \$1,173,000. Conversely a decrease of 10% applied to the probability assumptions, with all other variables held constant, would decrease the contingent consideration payable by \$1,173,000; and
- (b) The probability adjusted cash flows are discounted at a rate of 22.7% which is management's best estimate of the Company's cost of capital. An increase of 5% to the discount rate would decrease the contingent consideration payable by \$885,502. Conversely, a decrease of 5% to the discount rate would increase the contingent consideration payable by \$1,215,524.

Share Based Payments and Warrants

When the Company issues stock options and warrants, an estimate of fair value is derived for the equity instrument using the Black-Scholes option pricing model. The application of this option pricing model requires management to make assumptions regarding several variables, including the period for which the instrument will be outstanding, the price volatility of the Company's stock over a relevant timeframe, the determination of a relevant risk free interest rate and an assumption regarding the Company's dividend policy in the future. If other assumptions are used, the value derived for the equity instruments could be significantly impacted.

(b) Judgments

Recognition of Revenue

The Company has recognized as revenue all amounts that have been received under the contracts with Elan and Lilly. The recognition of revenue requires judgment in evaluating the contractual terms and assessing the Company's performance towards meeting the contractual obligations.

ACCOUNTING CHANGES

The following accounting policies have been adopted effective July 1, 2013:

IFRS 10 – Consolidated Financial Statements requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. IFRS 10 replaced SIC-12, Consolidation – Special Purpose

Entities, and parts of IAS 27, Consolidated and Separate Financial Statements. The adoption of IFRS 10 did not impact the Company's consolidated financial statements;

IFRS 12 – Disclosure of Interests in Other Entities establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interest in other entities. The adoption of IFRS 12 did not have an impact on the Company's consolidated financial statements; and

IFRS 13 – Fair Value Measurement is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in a transaction between market participants, at the measurement date. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any adjustments to the Company's consolidated financial statements.

IFRS ISSUED BUT NOT YET ADOPTED

IAS 36 – Impairment of Assets

IAS 36 has been amended to include limited scope amendments to the impairment disclosures. The amendments are effective for annual periods beginning on or after January 1, 2014. The Company has not determined the impact of the adoption of this IFRS on the Company's consolidated financial statements.

IFRS 2 – Share Based Payments

IFRS 2 has been amended to clarify the definition of vesting conditions. The amendments are effective for annual periods beginning on or after July 1, 2014. The Company has not determined the impact of the adoption of IFRS 2 on the Company's consolidated financial statements.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with some informative, relevant disclosures. The standard supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts. IFRS 15 must be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2017 and early adoption is permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Management's Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of management, including the Company's CEO and CFO, the Company conducted an evaluation of the effectiveness of its disclosure controls and procedures as of June 30, 2014 as required by Canadian securities legislation. Disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) are designed to ensure that the information required to be disclosed by the Company in the reports it files or submits under securities legislation is recorded, processed, summarized and reported on a timely

MANAGEMENT'S DISCUSSION AND ANALYSIS

basis and that such information is accumulated and reported to management, including the Company's CEO and CFO, as appropriate, to allow required disclosures to be made in a timely fashion. Based on their evaluation, the CEO and CFO have concluded that as of June 30, 2014, the Company's disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (1992) ("COSO") in Internal Control-Integrated Framework. The Company's management, including the CEO and CFO, concluded that, as of June 30, 2014, the Company's internal control over financial reporting was effective based on the criteria in Internal Control — Integrated Framework issued by COSO.

The effectiveness of the Company's internal control over financial reporting as of June 30, 2014 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in its report in the Company's audited consolidated financial statements for the year ended June 30, 2014.

LIQUIDITY AND CAPITAL RESOURCES

Overview

The Company commenced operations in July 1998, and has devoted its resources primarily to fund its research and development programs. All revenue to date has been generated from interest income on surplus funds, milestone payments, and licensing fees. The Company has incurred a cumulative deficit to June 30, 2014 of \$171,115,171. Losses are expected to continue for the next several years as the Company invests in research and development, preclinical studies, clinical trials, manufacturing and regulatory compliance.

Since inception, the Company has been financed primarily from public and private sales of equity, the exercise of warrants

and stock options, interest earned on cash deposits and short term investments and revenues and reimbursements from partners.

The Company's cash and short term investments were \$60,271,566 at June 30, 2014 as compared to \$28,125,639 at June 30, 2013, resulting in an increase of \$32,145,927. The Company's working capital position at June 30, 2014 increased \$29,272,146 from \$25,505,725 at June 30, 2013 to \$54,777,871 at June 30, 2014.

The increase in the Company's cash and short term investments as well as the increase in working capital is primarily due to the net proceeds of \$16.4 million received from Perrigo in exchange for 2,255,640 Transition common shares as well as the \$11.4 million and \$18.3 million received from the private placement equity financings which closed on August 15, 2013 and June 23, 2014 respectively.

The increase in the Company's cash and short term investments as well working capital has been partially offset by expenditures incurred during the fiscal year ended June 30, 2014.

The Company's current cash projection indicates that the current cash resources should enable the Company to execute its core business plan and meet its projected cash requirements beyond the next 12 months.

The success of the Company is dependent on its ability to bring its products to market, obtain the necessary regulatory approvals and achieve future profitable operations. The continuation of the research and development activities and the commercialization of its products are dependent on the Company's ability to successfully complete these activities and to obtain adequate financing through a combination of financing activities, operations, and partnerships. It is not possible to predict either the outcome of future research and development programs or the Company's ability to fund these programs going forward.

Financial Instruments

Financial instruments of the Company consist mainly of cash and cash equivalents, short term investments, accounts payable and accrued liabilities, and contingent consideration payable. Management's primary investment objective is to maintain safety of principal and provide adequate liquidity to meet all current payment obligations and future planned expenditures.

The Company is exposed to market risks related to volatility in interest rates for the Company's investment portfolio and foreign currency exchange rates related to investments and purchases of supplies and services made in U.S. dollars.

The Company is exposed to interest rate risk to the extent that the cash equivalents and short term investments are at a fixed rate of interest and their market value can vary with the change in market interest rates. The Company's maximum exposure to interest rate risk is based on the effective interest rate of the current carrying value of these assets. The Company does not speculate on interest rates and holds all deposits until their date of maturity.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Contractual Obligations

Minimum payments under our contractual obligations are as follows:

| | Less than 1 year \$ | 1 - 3 years \$ | 4 - 5 years \$ | After 5 years \$ | Total \$ |
|---|------------------------|-------------------|-------------------|---------------------|-------------------|
| Lilly Phase 2 | 14,938,000 | - | - | - | 14,938,000 |
| Operating leases | 235,705 | 58,481 | - | - | 294,186 |
| Collaboration agreements | 38,412 | - | - | - | 38,412 |
| Clinical and toxicity study agreements | 11,970,506 | 1,642,532 | - | - | 13,613,038 |
| Manufacturing agreements | 128,049 | - | - | - | 128,049 |
| Contingent consideration payable | - | 2,847,759 | - | 50,748,760 | 53,596,519 |
| Other | 482,012 | - | - | - | 482,012 |
| TOTAL | 27,792,684 | 4,548,772 | - | 50,748,760 | 83,090,216 |

Contractual obligations denominated in US dollars have been translated to Canadian dollars using the exchange rate at June 30, 2014.

PROPOSED TRANSACTIONS

On July 19, 2013, the Company's shelf registration statement filed with the United States Securities and Exchange Commission on Form F-3 became effective. The shelf prospectus provides for the potential offering in the United States of up to an aggregate amount of US\$50 million of Transition's common shares, warrants, or a combination thereof, from time to time in one or more offerings until July 19, 2016. Utilization of the US shelf prospectus is dependent upon meeting certain market capitalization thresholds at the time of financing.

RELATED PARTY TRANSACTIONS

During fiscal 2014, the Company paid legal fees to a law firm where the Company's Secretary is a partner and to a corporation controlled by the Company's Secretary. Total fees and disbursements charged to the Company by these companies was \$4,000 [2013 – nil] and are included in general and administrative expenses. The balance owing at June 30, 2014 and 2013 is nil.

Members of the Company's Board of Directors, management and employees participated in both the August, 2013 and June, 2014 private placements.

These transactions occurred in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

OUTSTANDING SHARE DATA

Authorized

The authorized share capital of the Company consists of an unlimited number of common shares.

Issued and Outstanding

The following details the issued and outstanding equity securities of the Company:

Common Shares

As at September 19, 2014, the Company has 35,306,183 common shares outstanding.

Stock Options

During the year ended June 30, 2014, the Company issued a total of 742,000 stock options, as follows.

- (i) on June 12, 2014, the Company issued 682,000 stock options with an exercise price of \$6.00 and an expiry date of June 12, 2024; and
- (ii) on June 30, 2014, the Company issued 60,000 stock options with an exercise price of \$7.47 and an expiry date of June 30, 2024.

As at September 19, 2014 the Company has 2,303,319 stock options outstanding with exercise prices ranging from \$2.09 to \$7.47 and various expiry dates extending to June 30, 2024. At September 19, 2014, on an if-converted basis, these stock options would result in the issuance of 2,303,319 common shares in the capital of the Company at an aggregate exercise price of \$8,999,867.

Warrants

During the year ended June 30, 2014, the Company issued a total of 3,852,591 warrants, as follows.

- (i) on August 15, 2013, the Company issued 853,223 warrants with a purchase price of US\$4.60 and 1,050,118 warrants with a purchase price of US\$6.50; and
- (ii) on June 23, 2014, the Company issued 1,949,250 warrants with a purchase price of US\$7.10.

Each warrant entitles the holder, within two years of the issuance date, to purchase one additional common share in the capital of the Company.

RISKS AND UNCERTAINTIES

Investing in the Company's securities involves a high degree of risk. Before making an investment decision, individuals should carefully consider the following risk factors, in addition to the other information provided in this MD&A and the Company's other disclosure documents filed on www.sedar.com.

The Company will require significant additional financing and it may not have access to sufficient capital.

The Company anticipates that it will need additional financing in the future to fund its ongoing research and development programs and for general corporate requirements. The Company may choose to seek additional funding through public or private offerings, corporate collaborations or partnership arrangements. The amount of financing required will depend on many factors including the financial requirements of the Company to fund its research and clinical trials, and the ability of the Company to secure partnerships and achieve partnership milestones as well as to fund other working capital requirements. The Company's ability to access the capital markets or to enlist partners is mainly dependent on the progress of its research and development and regulatory approval of its products. There is no assurance that additional funding will be available on acceptable terms, if at all.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company has a history of losses, and it has not generated any product revenue to date. It may never achieve or maintain profitability.

Since inception, the Company has incurred significant losses each year and expects to incur significant operating losses as the Company continues product research and development and clinical trials. There is no assurance that the Company will ever successfully commercialize or achieve revenues from sales of its therapeutic products if they are successfully developed or that profitability will ever be achieved or maintained. Even if profitability is achieved, the Company may not be able to sustain or increase profitability.

We are an early stage development company in an uncertain industry.

The Company is at an early stage of development. Preclinical and clinical trial work must be completed before our products could be ready for use within the markets we have identified. We may fail to develop any products, to obtain regulatory approvals, to enter clinical trials or to commercialize any products. We do not know whether any of our potential product development efforts will prove to be effective, meet applicable regulatory standards, obtain the requisite regulatory approvals or be capable of being manufactured at a reasonable cost. If the Company's products are approved for sale, there can be no assurance that the products will gain market acceptance among consumers, physicians, patients and others in the medical community. A failure to gain market acceptance may adversely affect the revenues of the Company.

The Company is subject to a strict regulatory environment.

None of the Company's product candidates have received regulatory approval for commercial sale.

Numerous statutes and regulations govern human testing and the manufacture and sale of human therapeutic products in Canada, the United States and other countries where the Company intends to market its products. Such legislation and regulation bears upon, among other things, the approval of protocols and human testing, the approval of manufacturing facilities, testing procedures and controlled research, review and approval of manufacturing, preclinical and clinical data prior to marketing approval including adherence to Good Manufacturing Practices ("GMP") during production and storage as well as regulation of marketing activities including advertising and labelling.

The completion of the clinical testing of our product candidates and the obtaining of required approvals are expected to take years and require the expenditure of substantial resources. There can be no assurance that clinical trials will be completed successfully within any specified period of time, if at all. Furthermore, clinical trials may be delayed or suspended at any time by the Company or by regulatory authorities if it is determined at any time that patients may be or are being exposed to unacceptable health risks, including the risk of death, or that compounds are not manufactured under acceptable GMP conditions or with acceptable quality. Any failure or delay in obtaining regulatory approvals would adversely affect the Company's ability to utilize its technology thereby adversely affecting operations. No assurance can be given that the Company's product candidates or lead compounds will prove to be safe and effective in clinical trials or that they will receive the requisite protocol approval or regulatory approval. Furthermore, no assurance can be given that current regulations relating to regulatory approval will not change or become more stringent. There are no assurances the Company can scale-up, formulate or manufacture any compound in sufficient quantities with acceptable specifications for the regulatory agencies to grant approval or not require additional changes or additional trials be performed. The agencies may also require additional trials be run in order to provide additional information regarding the safety, efficacy or equivalency of any compound for which the Company seeks regulatory approval. Similar restrictions are imposed in foreign markets other than the United States and Canada. Investors should be aware of the risks, problems, delays, expenses and difficulties which may be encountered by the Company in light of the extensive regulatory environment in which the Company's business operates.

Even if a product candidate is approved by the FDA or any other regulatory authority, the Company may not obtain approval for an indication whose market is large enough to recoup its investment in that product candidate. The Company may never obtain the required regulatory approvals for any of its product candidates.

The Company is faced with uncertainties related to its research.

The Company's research programs are based on scientific hypotheses and experimental approaches that may not lead to desired results. In addition, the timeframe for obtaining proof of principle and other results may be considerably longer than originally anticipated, or may not be possible given time, resource, financial, strategic and collaborator scientific constraints. Success in one stage of testing is not necessarily an indication that the particular program will succeed in later stages of testing and development. It is not possible to predict, based upon studies in in-vitro models and in animals, whether any of the compounds made for these programs will prove to be safe, effective, and suitable for human use. Each compound will require additional research and development, scale-up, formulation and extensive clinical testing in humans. Decisions regarding future development activities may be based on results from completed studies or interim results from on-going studies or projections derived from interim or administrative analyses of studies not yet completed. Development of these compounds will require investigations into the mechanism of action of the molecules as these are not fully understood. Unsatisfactory results obtained from a particular study relating to a program may cause the Company to abandon its commitment to that program or to the lead compound or product candidate being tested. The discovery of unexpected toxicities, lack of sufficient efficacy, poor physiochemical properties, unacceptable ADME (absorption, distribution, metabolism and excretion) and DMPK (drug metabolism and pharmacokinetics), pharmacology, inability to increase scale of manufacture, market attractiveness, regulatory hurdles, competition, as well as other factors, may make the Company's targets, lead compounds or product candidates unattractive or unsuitable for human use, and the Company may abandon its commitment to that program, target, lead compound or product candidate. In addition, preliminary results seen in animal and/or limited human testing may not be substantiated in larger controlled clinical trials.

If difficulties are encountered enrolling patients in the Company's clinical trials, the Company's trials could be delayed or otherwise adversely affected.

Clinical trials for the Company's product candidates require that the Company identify and enrol a large number of patients with the disorder under investigation. The Company may not be able to enrol a sufficient number of patients to complete its clinical trials in a timely manner. Patient enrolment is a function of many factors including, but not limited to, design of the study protocol, size of the patient population, eligibility criteria for the study, the perceived risks and benefits of the therapy under study, the patient referral practices of physicians and the availability of clinical trial sites. If the Company has difficulty enrolling a sufficient number of patients to conduct the Company's clinical trials as planned, it may need to delay or terminate ongoing clinical trials.

Even if regulatory approvals are obtained for the Company's product candidates, the Company will be subject to ongoing government regulation.

Even if regulatory authorities approve any of the Company's human therapeutic product candidates, the manufacture, marketing and sale of such products will be subject to strict and ongoing regulation. Compliance with such regulation may be expensive and consume substantial financial and management resources. If the Company, or any future marketing collaborators or contract manufacturers, fail to comply with applicable regulatory requirements, it may be subject to sanctions including fines, product recalls or seizures, injunctions, total or partial suspension of production, civil penalties, withdrawal of regulatory approvals and criminal prosecution. Any of these sanctions could delay or prevent the promotion, marketing or sale of the Company's products.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company may not achieve its projected development goals in the time frames announced and expected.

The Company sets goals for and makes public statements regarding the timing of the accomplishment of objectives material to its success, such as the commencement and completion of clinical trials, anticipated regulatory submission and approval dates and time of product launch. The actual timing of these events can vary dramatically due to factors such as delays or failures in the Company's clinical trials, the uncertainties inherent in the regulatory approval process and delays in achieving manufacturing or marketing arrangements sufficient to commercialize its products.

There can be no assurance that the Company's clinical trials will be completed, that the Company will make regulatory submissions or receive regulatory approvals as planned. If the Company fails to achieve one or more of these milestones as planned, the price of the Common Shares would likely decline.

If the Company fails to obtain acceptable prices or adequate reimbursement for its human therapeutic products, its ability to generate revenues will be diminished.

The Company's ability to successfully commercialize its human therapeutic products will depend significantly on its ability to obtain acceptable prices and the availability of reimbursement to the patient from third-party payers, such as government and private insurance plans. While the Company has not commenced discussions with any such parties, these third-party payers frequently require companies to provide predetermined discounts from list prices, and they are increasingly challenging the prices charged for pharmaceuticals and other medical products. The Company's human therapeutic products may not be considered cost-effective, and reimbursement to the patient may not be available or sufficient to allow the Company to sell its products on a competitive basis. The Company may not be able to negotiate favourable reimbursement rates for its human therapeutic products.

In addition, the continuing efforts of third-party payers to contain or reduce the costs of healthcare through various means may limit the Company's commercial opportunity and reduce any associated revenue and profits. The Company expects proposals to implement similar government control to continue. In addition, increasing emphasis on managed care will continue to put pressure on the pricing of pharmaceutical and biopharmaceutical products. Cost control initiatives could decrease the price that the Company or any current or potential collaborators could receive for any of its human therapeutic products and could adversely affect its profitability. In addition, in Canada and in many other countries, pricing and/or profitability of some or all prescription pharmaceuticals and biopharmaceuticals are subject to government control.

If the Company fails to obtain acceptable prices or an adequate level of reimbursement for its products, the sales of its products would be adversely affected or there may be no commercially viable market for its products.

The Company may not obtain adequate protection for its products through its intellectual property.

The Company's success depends, in large part, on its ability to protect its competitive position through patents, trade secrets, trademarks and other intellectual property rights. The patent positions of pharmaceutical and biopharmaceutical firms, including the Company, are uncertain and involve complex questions of law and fact for which important legal issues remain unresolved. The patents issued or to be issued to the Company may not provide the Company with any competitive advantage. The Company's patents may be challenged by third parties in patent litigation, which is becoming widespread in the biopharmaceutical industry. In addition, it is possible that third parties with products that are very similar to the Company's will circumvent its patents by means of alternate designs or processes. The Company may have to rely on method of use protection for its compounds in development and any resulting products, which may not confer the same protection as compounds per se. The Company may be required to disclaim part of the term of certain patents. There may be prior applications of which the Company is not aware that may affect the validity or enforceability of a patent claim. There also may be prior applications which are not viewed by the Company as

affecting the validity or enforceability of a claim, but which may, nonetheless ultimately be found to affect the validity or enforceability of a claim. No assurance can be given that the Company's patents would, if challenged, be held by a court to be valid or enforceable or that a competitor's technology or product would be found by a court to infringe the Company's patents. Applications for patents and trademarks in Canada, the United States and in foreign markets have been filed and are being actively pursued by the Company. Pending patent applications may not result in the issuance of patents, and the Company may not develop additional proprietary products which are patentable.

Patent applications relating to or affecting the Company's business have been filed by a number of pharmaceutical and biopharmaceutical companies and academic institutions. A number of the technologies in these applications or patents may conflict with the Company's technologies, patents or patent applications, and such conflict could reduce the scope of patent protection which the Company could otherwise obtain. The Company could become involved in interference proceedings in the United States in connection with one or more of its patents or patent applications to determine priority of invention. The Company's granted patents could also be challenged and revoked in opposition proceedings in certain countries outside the United States.

In addition to patents, the Company relies on trade secrets and proprietary know-how to protect its intellectual property. The Company generally requires its employees, consultants, outside scientific collaborators and sponsored researchers and other advisors to enter into confidentiality agreements. These agreements provide that all confidential information developed or made known to the individual during the course of the individual's relationship with the Company is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of the Company's employees, the agreements provide that all of the technology which is conceived by the individual during the course of employment is the Company's exclusive property. These agreements may not provide meaningful protection or adequate remedies in the event of unauthorized use or disclosure of the Company's proprietary information. In addition, it is possible that third parties could independently develop proprietary information and techniques substantially similar to those of the Company or otherwise gain access to the Company's trade secrets.

The Company currently has the right to use certain technology under license agreements with third parties. The Company's failure to comply with the requirements of material license agreements could result in the termination of such agreements, which could cause the Company to terminate the related development program and cause a complete loss of its investment in that program.

As a result of the foregoing factors, the Company may not be able to rely on its intellectual property to protect its products in the marketplace.

The Company may infringe the intellectual property rights of others.

The Company's commercial success depends significantly on its ability to operate without infringing the patents and other intellectual property rights of third parties. There could be issued patents of which the Company is not aware that its products infringe or patents, that the Company believes it does not infringe, but that it may ultimately be found to infringe. Moreover, patent applications are in some cases maintained in secrecy until patents are issued. The publication of discoveries in the scientific or patent literature frequently occurs substantially later than the date on which the underlying discoveries were made and patent applications were filed. Because patents can take many years to issue, there may be currently pending applications of which the Company is unaware that may later result in issued patents that its products infringe.

The biopharmaceutical industry has produced a proliferation of patents, and it is not always clear to industry participants, including the Company, which patents cover various types of products. The coverage of patents is subject to interpretation by the courts, and the interpretation is not always uniform. The Company is aware of, and has reviewed, third party patents relating to the treatment of Alzheimer's disease, diabetes and other relevant indication

MANAGEMENT'S DISCUSSION AND ANALYSIS

areas. In the event of infringement or violation of another party's patent, the Company may not be able to enter into licensing arrangements or make other arrangements at a reasonable cost. Any inability to secure licenses or alternative technology could result in delays in the introduction of the Company's products or lead to prohibition of the manufacture or sale of the products.

Patent litigation is costly and time consuming and may subject the Company to liabilities.

The Company's involvement in any patent litigation, interference, opposition or other administrative proceedings will likely cause the Company to incur substantial expenses, and the efforts of its technical and management personnel will be significantly diverted. In addition, an adverse determination in litigation could subject the Company to significant liabilities.

The Company operates in a fiercely competitive business environment.

The biopharmaceutical industry is highly competitive. Competition comes from healthcare companies, pharmaceutical companies, large and small biotech companies, specialty pharmaceutical companies, universities, government agencies and other public and private companies. Research and development by others may render the Company's technology or products non-competitive or obsolete or may result in the production of treatments or cures superior to any therapy the Company is developing or will develop. In addition, failure, unacceptable toxicity, lack of sales or disappointing sales or other issues regarding competitors' products or processes could have a material adverse effect on the Company's product candidates, including its clinical candidates or its lead compounds.

The market price of the Company's Common Shares may experience a high level of volatility due to factors such as the volatility in the market for biotechnology stocks generally, and the short-term effect of a number of possible events.

The Company is a public growth company in the biotechnology sector. As frequently occurs among these companies, the market price for the Company's Common Shares may experience a high level of volatility. Numerous factors, including many over which the Company has no control, may have a significant impact on the market price of Common Shares including, among other things, (i) clinical and regulatory developments regarding the Company's products and product candidates and those of its competitors, (ii) arrangements or strategic partnerships by the Company, (iii) other announcements by the Company or its competitors regarding technological, product development, sales or other matters, (iv) patent or other intellectual property achievements or adverse developments, (v) arrivals or departures of key personnel; (vi) government regulatory action affecting the Company's product candidates in the United States, Canada and foreign countries, (vii) actual or anticipated fluctuations in the Company's revenues or expenses, (viii) general market conditions and fluctuations for the emerging growth and biopharmaceutical market sectors, (ix) reports of securities analysts regarding the expected performance of the Company, and (x) events related to threatened, new or existing litigation. Listing on NASDAQ and the TSX may increase share price volatility due to various factors including, (i) different ability to buy or sell the Company's Common Shares, (ii) different market conditions in different capital markets; and (iii) different trading volume.

In addition, the stock market in recent years has experienced extreme price and trading volume fluctuations that often have been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations may adversely affect the price of Common Shares, regardless of the Company's operating performance. In

addition, sales of substantial amounts of Common Shares in the public market after any offering, or the perception that those sales may occur, could cause the market price of Common Shares to decline.

Furthermore, shareholders may initiate securities class action lawsuits if the market price of the Company's stock drops significantly, which may cause the Company to incur substantial costs and could divert the time and attention of its management.

The Company is highly dependent on third parties.

The Company is or may in the future be dependent on third parties for certain raw materials, product manufacture, marketing and distribution and, like other biotechnology and pharmaceutical companies, upon medical institutions to conduct clinical testing of its potential products. Although the Company does not anticipate any difficulty in obtaining any such materials and services, no assurance can be given that the Company will be able to obtain such materials and services.

The Company is subject to intense competition for its skilled personnel, and the loss of key personnel or the inability to attract additional personnel could impair its ability to conduct its operations.

The Company is highly dependent on its management and its clinical, regulatory and scientific staff, the loss of whose services might adversely impact its ability to achieve its objectives. Recruiting and retaining qualified management and clinical, scientific and regulatory personnel is critical to the Company's success. Competition for skilled personnel is intense, and the Company's ability to attract and retain qualified personnel may be affected by such competition.

The Company's business involves the use of hazardous materials which requires the Company to comply with environmental regulation.

The Company's discovery and development processes involve the controlled use of hazardous 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. The risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, the Company could be held liable for any damages that result, and any such liability could exceed the Company's resources. The Company may not be adequately insured against this type of liability. The Company may be required to incur significant costs to comply with environmental laws and regulations in the future, and its operations, business or assets may be materially adversely affected by current or future environmental laws or regulations.

Legislative actions, potential new accounting pronouncements and higher insurance costs are likely to impact the Company's future financial position or results of operations.

Compliance with changing regulations regarding corporate governance and public disclosure, notably with respect to internal controls over financial reporting, may result in additional expenses. Changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for companies such as ours, and insurance costs are increasing as a result of this uncertainty.

Future healthcare reforms may produce adverse consequences.

Healthcare reform and controls on healthcare spending may limit the price the Company can charge for any products

MANAGEMENT'S DISCUSSION AND ANALYSIS

and the amounts thereof that it can sell. In particular, in the United States, the federal government and private insurers have considered ways to change, and have changed, the manner in which healthcare services are provided. Potential approaches and changes in recent years include controls on healthcare spending and the creation of large purchasing groups. In the future, the U.S. government may institute further controls and different reimbursement schemes and limits on Medicare and Medicaid spending or reimbursement. These controls, reimbursement schemes and limits might affect the payments the Company could collect from sales of any of its products in the United States. Uncertainties regarding future health care reform and private market practices could adversely affect the Company's ability to sell any products profitably in the United States. Election of new or different political or government officials in large market countries could lead to dramatic changes in pricing, regulatory approval legislation and reimbursement which could have material impact on product approvals and commercialization.

The Company faces an unproven market for its future products.

The Company believes that there will be many different applications for products successfully derived from its technologies and that the anticipated market for products under development will continue to expand. No assurance, however, can be given that these beliefs will prove to be correct due to competition from existing or new products and the yet to be established commercial viability of the Company's products. Physicians, patients, formularies, third party payers or the medical community in general may not accept or utilize any products that the Company or its collaborative partners may develop.

The Company may be faced with future lawsuits related to secondary market liability.

Securities legislation in Canada has recently changed to make it easier for shareholders to sue. These changes could lead to frivolous law suits which could take substantial time, money, resources and attention or force the Company to settle such claims rather than seek adequate judicial remedy or dismissal of such claims.

The Company may encounter unforeseen emergency situations and information technology breaches.

Despite the implementation of security measures, any of the Company's, its collaborators' or its third party service providers' internal computer systems are vulnerable to damage from computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failure. Any resulting system failure, accident or security breach could result in a material disruption of the Company's operations. Likewise, data privacy or security breaches by employees and others with permitted access to our systems, including in some cases third-party service providers to which we may outsource certain business functions, may pose a risk that sensitive data, including intellectual property or personal information, may be exposed to unauthorized persons or to the public. While we have invested in the protection of data and information technology, there can be no assurance that our efforts will prevent service interruptions, or identify breaches in our systems, that could adversely affect our business and/or result in the loss of critical or sensitive information, which could result in financial, legal, business or reputational harm to us.

The Company's technologies may become obsolete.

The pharmaceutical industry is characterized by rapidly changing markets, technology, emerging industry standards and frequent introduction of new products. The introduction of new products embodying new technologies, including new manufacturing processes, and the emergence of new industry standards may render the Company's technologies obsolete, less competitive or less marketable.

Our product candidates may cause undesirable serious adverse events during clinical trials that could delay or prevent their regulatory authorization, approval or other permission to conduct further testing or commence commercialization.

Our product candidates in clinical development, including ELND005 can potentially cause adverse events. Most recently, together with our collaborator, Elan, we completed a Phase 2 study that evaluated three dose groups of ELND005 and a placebo group in mild to moderate Alzheimer's disease patients. The study included four treatment arms: placebo, 250mg bid, 1000mg bid and 2000mg bid. The two high dose ELND005 groups were electively discontinued in 2009 by the companies due to an observed imbalance of serious adverse events, including deaths. No causal relationship could be determined between these higher doses and the events.

Of the 351 subjects who received study drug, a total of 171 subjects received either 250mg bid or placebo, the rest were in the two discontinued high dose groups. The overall incidence of adverse events in the 250mg bid and placebo groups was 87.5% versus 91.6%; and the incidence of withdrawals due to adverse events was 10.2% versus 9.6%, respectively. The incidence of serious adverse events in the 250mg bid and placebo groups was 21.6% versus 13.3%, but the incidence of serious adverse events that were considered drug related was 2.3% and 2.4%, respectively. The total number of deaths in the study was five and four in the 1000mg bid and 2000mg bid dose groups versus one and zero in the 250mg bid and placebo groups, respectively. These deaths occurred between August 2008 and November 2009. The study's independent safety monitoring committee reviewed the final safety results and continued to conclude that a causal relationship between the deaths and drug could not be determined.

The most common adverse events in the 250mg bid group that were >5% in incidence and double the placebo rate were: falls (12.5% vs. placebo 6%), depression (11.4% vs. placebo 4.8%), and confusional state (8% vs. placebo 3.6%). Because our product candidates have been tested in relatively small patient populations and for limited durations, additional adverse events may be observed as their development progresses.

Adverse events caused by any of our product candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in the denial of regulatory approval by the FDA or other non-U.S. regulatory authorities for any or all targeted indications. This, in turn, could prevent the commercialization of our product candidates and the generation of revenues from their sale. In addition, if our product candidates receive authorization, marketing approval or other permission and we or others later identify adverse events caused by the product, the material adverse consequences that may arise, include, but are not limited to:

- regulatory authorities may withdraw their authorization, approval, or other permission to test or market the candidate product;
- we may be required to recall the product, change the way the product is administered, conduct additional clinical trials or change the labeling of the product;
- a product may become less competitive and product sales may decrease; or
- our reputation may suffer.

Any one or a combination of these events could prevent us from achieving or maintaining market acceptance or could substantially increase the costs and expenses of commercializing the product candidate, which in turn could delay or prevent us from generating significant revenues from the sale of such products.

We may be subject to costly product liability claims and may not have adequate insurance.

The conduct of clinical trials in humans involves the potential risk that the use of our product candidates will result in adverse effects. We currently maintain product liability insurance for our clinical trials; however, such liability insurance may not be adequate to fully cover any liabilities that arise from clinical trials of our product candidates. We may not have sufficient resources to pay for any liabilities resulting from a claim excluded from, or beyond the limit of, our insurance coverage.

MANAGEMENT'S RESPONSIBILITY TO FINANCIAL STATEMENTS

The accompanying consolidated financial statements of **Transition Therapeutics Inc.** have been prepared by management and have been approved by the Board of Directors. Management is responsible for the information and representation contained in these consolidated financial statements.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and include some amounts that are based on best estimates and judgments.

Management, to meet its responsibility for integrity and objectivity of the data in the consolidated financial statements, has developed and maintains a system of internal accounting controls. Management believes that this system of internal accounting controls provides reasonable assurance that the financial records are reliable and form a proper basis for preparation of the consolidated financial statements, and that the assets are properly accounted for and safeguarded.

The Audit Committee reviews the consolidated financial statements, adequacy of internal controls, audit process and financial reporting with management. The Audit Committee, which consists of three directors not involved in the daily operations of the Company, reports to the Board of Directors prior to their approval of the audited consolidated financial statements for publication.

The shareholders' auditors have full access to the Audit Committee, with and without management being present, to discuss the consolidated financial statements and to report their findings from the audit process. The consolidated financial statements have been examined by the shareholders' independent auditors, PricewaterhouseCoopers LLP Chartered Professional Accountants, and their report is provided herein



Tony Cruz
Chief Executive Officer



Nicole Rusaw
Chief Financial Officer

September 19, 2014

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Transition Therapeutics Inc.

We have completed an integrated audit of Transition Therapeutics Inc. and its subsidiaries' June 30, 2014 consolidated financial statements and their internal control over financial reporting as at June 30, 2014 and an audit of their June 30, 2013 consolidated financial statements. Our opinions, based on our audits, are presented below.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Transition Therapeutics Inc. and its subsidiaries, which comprise the consolidated balance sheets as at June 30, 2014 and June 30, 2013 and the consolidated statements of income (loss) and comprehensive income (loss), shareholders' equity and cash flows for the years then ended and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits as at June 30, 2014 and June 30, 2013 and for the years then ended in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. Canadian generally accepted auditing standards also require that we comply with ethical requirements.

An audit involves performing procedures to obtain audit evidence, on a test basis, about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting principles and policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion on the consolidated financial statements.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Transition Therapeutics Inc. and its subsidiaries as at June 30, 2014 and June 30, 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Report on Internal Control Over Financial Reporting

We have also audited Transition Therapeutics Inc. and its subsidiaries' internal control over financial reporting as at June 30, 2014, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

INDEPENDENT AUDITOR'S REPORT

Management's responsibility for internal control over financial reporting

Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, appearing in the 2014 Annual Report to Shareholders in the section entitled "Internal Controls Over Financial Reporting".

Auditor's responsibility

Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances.

We believe that our audit provides a reasonable basis for our audit opinion on the company's internal control over financial reporting.

Definition of internal control over financial reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Inherent limitations

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Opinion

In our opinion, Transition Therapeutics Inc. and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as at June 30, 2014, based on criteria established in Internal Control - Integrated Framework (1992) issued by COSO.

PricewaterhouseCoopers LLP
Chartered Professional Accountants, Licensed Public Accountants
Toronto, Ontario
September 19, 2014

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the years ended June 30, 2014 and 2013

CONSOLIDATED BALANCE SHEETS

(In Canadian dollars)

| | Note | June 30 2014 \$ | June 30, 2013 \$ |
|---|------|--------------------|---------------------|
| Assets | | | |
| Current assets | | | |
| Cash | | 57,212,004 | 23,067,937 |
| Short term investments | 6 | 3,059,562 | 5,057,702 |
| Other receivables | | 220,514 | 35,792 |
| Investment tax credits receivable | | 212,393 | 180,652 |
| Prepaid expenses and deposits | | 36,656 | 359,164 |
| | | 60,741,129 | 28,701,247 |
| Non-current assets | | | |
| Property and equipment | | 158,926 | 168,034 |
| Intangible assets | 7 | 8,007,181 | 8,938,674 |
| Total assets | | 68,907,236 | 37,807,955 |
| Liabilities | | | |
| Current liabilities | | | |
| Trade and other payables | 8 | 5,963,258 | 874,149 |
| Current portion of contingent consideration payable | 9 | - | 2,321,373 |
| | | 5,963,258 | 3,195,522 |
| Non-current liabilities | | | |
| Contingent consideration payable | 9 | 3,838,286 | 1,434,958 |
| Leasehold inducement | | 11,432 | 22,863 |
| Total liabilities | | 9,812,976 | 4,653,343 |
| Equity attributable to owners of the Company | | | |
| Share capital | 11 | 207,374,493 | 165,367,524 |
| Warrants | 11 | 5,176,397 | - |
| Contributed surplus | 11 | 14,768,221 | 14,768,002 |
| Share-based payment reserve | 11 | 2,866,292 | 2,352,002 |
| Accumulated other comprehensive income | 11 | 24,028 | - |
| Deficit | | (171,115,171) | (149,332,916) |
| Total equity | | 59,094,260 | 33,154,612 |
| Total liabilities and equity | | 68,907,236 | 37,807,955 |

Contingencies and commitments 16

Subsequent event 21

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


Tony Cruz, Director


Christopher Henley, Director

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

For the years ended June 30, 2014 and 2013 *(In Canadian dollars)*

| | Note | 2014 \$ | 2013 \$ |
|---|------|--------------|-------------|
| Revenues | | | |
| Licensing fees | 10 | - | 17,933,500 |
| Expenses | | | |
| Research and development | 14 | 17,367,385 | 8,862,872 |
| Selling, general and administrative expenses | 14 | 4,726,574 | 3,557,792 |
| Changes in fair value of contingent consideration payable | 9 | (2,911,218) | - |
| Settlement of pre-existing relationship | 4, 9 | 3,096,186 | - |
| Impairment of intangible assets | | - | 6,545,821 |
| | | 22,278,927 | 18,966,485 |
| Operating loss | | (22,278,927) | (1,032,985) |
| Interest income | | 220,119 | 146,209 |
| Foreign exchange gain | | 284,523 | 910,073 |
| Loss on disposal of property and equipment | | (7,970) | - |
| Net income (loss) for the year | | (21,782,255) | 23,297 |
| Other comprehensive income (loss) for the year | | | |
| Items that may be subsequently reclassified to net income: | | | |
| Cumulative translation adjustment | | 24,028 | - |
| Comprehensive income (loss) for the year | | (21,758,227) | 23,297 |
| Basic and diluted net income (loss) per common share | 15 | (0.72) | 0.00 |

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended June 30, 2014 and 2013 *(In Canadian dollars)*

| | Note | Number of common shares # | Share capital \$ |
|--|------|------------------------------------|---------------------|
| Balance, July 1, 2013 | | 26,930,634 | 165,367,524 |
| Net loss for the year | | - | - |
| Cumulative translation adjustment | | - | - |
| Issued pursuant to private placements, net | 11 | 8,076,427 | 40,317,595 |
| Share options exercised, expired or cancelled | 11 | 296,852 | 1,689,374 |
| Share-based payment compensation expense | 11 | - | - |
| Balance, June 30, 2014 | | 35,303,913 | 207,374,493 |
| Balance, July 1, 2012 | | 26,921,302 | 165,334,259 |
| Net income and comprehensive income for the year | | - | - |
| Share options expired, exercised or cancelled | 11 | 9,332 | 33,265 |
| Share-based payment compensation expense | 11 | - | - |
| Balance, June 30, 2013 | | 26,930,634 | 165,367,524 |

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

Attributable to equity holders of the company

| Warrants \$ | Contributed surplus \$ | Share-based payment reserve \$ | Accumulated Other Comprehensive Income \$ | Deficit \$ | Total equity \$ |
|----------------|------------------------------|---|---|---------------|--------------------|
| - | 14,768,002 | 2,352,002 | - | (149,332,916) | 33,154,612 |
| - | - | - | - | (21,782,255) | (21,782,255) |
| - | - | - | 24,028 | - | 24,028 |
| 5,176,397 | - | - | - | - | 45,493,992 |
| - | 219 | (623,836) | - | - | 1,065,757 |
| - | - | 1,138,126 | - | - | 1,138,126 |
| 5,176,397 | 14,768,221 | 2,866,292 | 24,028 | (171,115,171) | 59,094,260 |
| - | 13,168,411 | 2,977,032 | - | (149,356,213) | 32,123,489 |
| - | - | - | - | 23,297 | 23,297 |
| - | 1,599,591 | (1,613,259) | - | - | 19,597 |
| - | - | 988,229 | - | - | 988,229 |
| - | 14,768,002 | 2,352,002 | - | (149,332,916) | 33,154,612 |

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended June 30, 2014 and 2013 (In Canadian dollars)

| | Note | 2014 \$ | 2013 \$ |
|--|------|---------------------|-------------------|
| Cash flows from (used in) operating activities | | | |
| Net income (loss) for the period | | (21,782,255) | 23,297 |
| Adjustments for: | | | |
| Change in fair value of contingent consideration payable | | (2,911,218) | - |
| Settlement of a pre-existing relationship | | 3,096,186 | - |
| Depreciation and amortization | | 946,897 | 1,820,101 |
| Share-based payment compensation expense | | 1,138,126 | 988,229 |
| Impairment of intangible assets | | - | 6,545,821 |
| Loss on disposal of property and equipment | | 7,970 | - |
| Accrued interest | | 5,140 | 524 |
| Unrealized foreign exchange gain | | (491,535) | (410,226) |
| Change in working capital | 17 | 5,257,439 | (278,479) |
| Net cash provided by (used in) operating activities | | (14,733,250) | 8,689,267 |
| Cash flows from (used in) investing activities | | | |
| Maturity of short term investments | | 5,018,000 | 9,023,910 |
| Purchase of short term investments | | (3,025,000) | (8,024,872) |
| Purchase of property and equipment | | (34,697) | (10,772) |
| Proceeds on disposal of property and equipment | | 9,000 | 5,500 |
| Net cash provided by investing activities | | 1,967,303 | 993,766 |
| Cash flows from financing activities | | | |
| Net proceeds from private placements | 11 | 45,493,992 | - |
| Net proceeds from exercise of options | | 1,065,757 | 19,597 |
| Net cash provided by financing activities | | 46,559,749 | 19,597 |
| Foreign exchange gains on cash | | 350,265 | 410,226 |
| Net increase in cash | | 34,144,067 | 10,112,856 |
| Cash and cash equivalents at beginning of year | | 23,067,937 | 12,955,081 |
| Cash at end of year | | 57,212,004 | 23,067,937 |

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

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 *(In Canadian dollars)*

1. GENERAL INFORMATION AND NATURE OF OPERATIONS

Transition Therapeutics Inc. and its subsidiaries (together the Company or Transition) was incorporated by Articles of Incorporation under the Business Corporations Act (Ontario) on July 6, 1998. The Company is a public company with common shares listed on both the NASDAQ and Toronto Stock Exchange and is incorporated and domiciled in Canada. The address of its registered office is 101 College Street, Suite 220, Toronto, Ontario, Canada.

The Company is a product-focused biopharmaceutical company developing therapeutics for disease indications with large markets. The Company's lead technologies are focused on the treatment of Alzheimer's disease and diabetes.

The success of the Company is dependent on bringing its products to market, obtaining the necessary regulatory approvals and achieving future profitable operations. The continuation of the research and development activities and the commercialization of its products are dependent on the Company's ability to successfully complete these activities and to obtain adequate financing through a combination of financing activities and operations. It is not possible to predict either the outcome of future research and development programs or the Company's ability to fund these programs going forward.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all periods presented.

2.1 Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The consolidated financial statements have been prepared using the historical cost convention except for the revaluation of certain financial assets and financial liabilities to fair value, including the contingent consideration payable.

The preparation of financial statements in conformity with IFRS requires use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

The consolidated financial statements were approved for issuance by the Board of Directors on September 19, 2014.

2.2 Consolidation

These consolidated financial statements incorporate the assets and liabilities of Transition and its wholly owned subsidiaries: Transition Therapeutics Leaseholds Inc., Waratah Pharmaceuticals Inc., Transition Therapeutics (USA) Inc. and Transition Therapeutics Ireland Limited. Intercompany transactions, balances and unrealized gains/losses on transactions between group companies are eliminated.

Subsidiaries are all those entities over which the Company has power over the investee, is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are fully consolidated from the date on which control is transferred to the Company and de-consolidated from the date that control ceases.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 *(In Canadian dollars)*

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Company's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statement of comprehensive income (loss).

2.3 Foreign Currency Translation

(i) Functional and presentation currency

Items included in the consolidated financial statements of each entity of the Company are measured using the currency of the primary economics environment in which the entity operates (the functional currency). These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The Company has determined that its foreign operations located in the United States and Ireland have a functional currency of U.S. dollars. Consequently, revenue and expenses of these foreign operations are recorded using the rate of exchange in effect at the dates of the transactions and the translation of assets and liabilities uses the rates of exchange in effect at the period-end date, with the resulting net unrealized gains and losses arising from the translation of these foreign operations included as part of the currency translation adjustment in other comprehensive income (loss).

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the rate of exchange in effect at the dates of the transactions. Foreign exchange gains and losses arising from translating monetary foreign currency balances are included in foreign exchange gain.

2.4 Property and equipment

Property and equipment is recorded at historical cost less depreciation. Historical cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of a replaced asset is derecognized when it is replaced. Repairs and maintenance costs are charged to the consolidated statement of comprehensive income (loss) during the period in which they are incurred. Depreciation of property and equipment is calculated using either the straight-line or diminishing balance methods to allocate the cost of each item over its estimated useful life, as follows:

| Asset class | Percentage | Method |
|--------------------------------|---------------------------------------|---------------------|
| Computer equipment | 30% - 45% | Diminishing balance |
| Office equipment and furniture | 20% | Diminishing balance |
| Laboratory equipment | 20% | Diminishing balance |
| Leasehold improvements | Term of lease plus one renewal period | Straight-line |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

On disposal of items of property and equipment, the cost and related accumulated depreciation and impairments are removed from the consolidated balance sheet and the net amount, less any proceeds, is taken to the consolidated statement of comprehensive income (loss).

2.5 Intangible assets

Intangible assets consist of intellectual property in the form of technology, patents, licenses and compounds. Separately acquired intangible assets are recorded at historical cost. Intangible assets acquired in a business combination are recognized at fair value at the acquisition date. All intangible assets have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of the intangible assets over their estimated useful lives of up to 20 years.

2.6 Impairment of non-financial assets

Property and equipment and intangible assets that are subject to amortization or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.7 Financial Instruments: Classification and Measurement

IFRS 9 was issued in November, 2009 and replaces parts of IAS 39 that relate to the classification and measurement of financial assets. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition. Adoption of IFRS 9 is mandatory from January 1, 2015 and earlier adoption is permitted. The Company has adopted IFRS 9 from July 1, 2010 as well as the related consequential amendments to other IFRSs, because this new accounting policy provides reliable and more relevant information for users to assess the amounts, timing and uncertainty of future cash flows.

The Company has assessed the financial assets held by the Company at July 1, 2010, the date of initial application of IFRS 9. Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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Financial assets measured at amortized cost

Cash and cash equivalents, short term investments and trade and other receivables meet the requirements of IFRS 9 and are measured at amortized cost as these assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have fixed maturities that the Company intends to hold until maturity. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets.

Financial liabilities measured at fair value

The Company's contingent consideration payable is measured at fair value at each reporting period with changes in the fair value being recorded in the consolidated statement of comprehensive income (loss). The estimate of fair value is based on management's best estimate of the timing and probability of having to make the contingent payments, discounted at the Company's weighted average cost of capital.

Fair Value Hierarchy

The Company categorizes its financial assets and liabilities that are recognized at fair value in the consolidated financial statements into one of three different levels. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels, which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 – inputs are based upon unadjusted quoted prices for identical instruments traded in active markets;

Level 2 – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities;

Level 3 – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

2.8 Impairment of financial assets

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The asset's carrying amount is reduced and the amount of the loss is recognized in the consolidated statement of comprehensive income (loss).

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the reversal of the previously recognized impairment is recognized in the consolidated statement of comprehensive income (loss).

2.9 Investment tax credits

Investment tax credits (ITCs) are accounted for as government assistance and are accrued when qualifying expenditures are made and there is reasonable assurance that the credits will be realized. Government assistance is accounted for using the cost reduction method, whereby they are netted against the related research and development expenses or capital expenditures to which they relate.

2.10 Other receivables

Trade and other receivables are amounts due for services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

Trade and other receivables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

2.11 Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

2.12 Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of new shares, warrants or options are shown in equity as a deduction, net of income tax, from the proceeds received.

2.13 Trade and other payables

Trade and other payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade and other payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

2.14 Current and deferred income tax

The income tax expense for the period comprises current and deferred tax. Income tax is recognized in the consolidated statement of comprehensive income (loss) except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 *(In Canadian dollars)*

income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects either accounting, taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that the assets can be recovered.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.15 Share-based payments

The Company has a stock option plan which is an equity settled, share-based payment compensation plan, under which the Company receives services from employees or consultants as consideration for equity instruments of the Company. The stock option plan is open to directors, officers, employees, members of the Scientific Advisory Board and consultants of the Company. The fair value of the employees or consultants services received in exchange for the grant of the options is recognized as an expense over the service period using the graded vesting method.

The fair value of stock options is estimated using the Black-Scholes option pricing model. This model requires the input of a number of assumptions, including expected dividend yield, expected share price volatility, expected time until exercise and risk-free interest rates. Although the assumptions used reflect management's best estimates, they involve inherent uncertainties based on conditions outside of the Company's control. Changes in these assumptions could significantly impact share-based payment compensation.

The share-based payment reserve, included in equity is reduced as the options are exercised or when the options expire unexercised. If the share options are exercised, cancelled or forfeited, the amount initially recorded for the options in share-based payment reserve is credited to common shares or contributed surplus, along with the proceeds received on the exercise. If the share options expire unexercised, the amount initially recorded for the options in the share based payment reserve is credited to contributed surplus.

2.16 Revenue recognition

Revenue comprises the fair value of consideration received or receivable for the sale of services in the ordinary course of the Company's activities. The Company recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Company's activities as described below.

The Company generally enters into two types of revenue producing arrangements with pharmaceutical companies: licensing arrangements and collaboration / co-development arrangements ("collaborations").

Licensing arrangements

Under a licensing arrangement the Company transfers the rights of a compound or series of compounds to a counterparty who directs the development, manufacture and commercialization of the product. The Company's additional involvement is limited to involvement in a joint steering committee which the Company generally considers

protective in nature. In return, the Company will generally receive an upfront fee, additional payments based on specifically defined developmental, regulatory, and commercial milestones, and a royalty based on a percentage of future sales of the product.

Revenue related to up-front payments received in licensing arrangements are deferred and amortized into income over the estimated term of the arrangement. Revenue from milestone payments are recognized when the milestones are achieved.

Collaboration arrangements

Under a collaboration arrangement the Company participates in the development by paying a fixed share of the development and commercialization costs in return for a fixed percentage of the product's future profits. For contributing rights to the intellectual property the co-collaborator will pay the Company an upfront fee and additional payments based on specifically defined developmental and regulatory milestones. Collaboration agreements generally require the Company to participate in joint steering committees and to participate actively in the research and development of the product.

The Company accounts for collaboration arrangements using the percentage of completion model. Under this method, revenue is recorded as related costs are incurred, on the basis of the proportion of actual costs incurred to date, related to the estimated total costs to be incurred under the arrangement. The cumulative impact of any revisions in cost and earnings estimates are reflected in the period in which the need for a revision becomes known. In the event that there are significant uncertainties with respect to the outcome of the contract, the Company uses a zero profit model whereby revenue will be recognized equal to direct costs incurred, but not in excess of cash received or receivable. Losses on these contracts are recorded in the period in which management has determined that a loss is expected.

The Company uses an input based measure, primarily direct costs or other appropriate inputs, to determine the percent complete because the Company believes that the inputs are representative of the value being conveyed through the research and development activities. The Company believes that using direct costs as the unit of measure of percentage complete also most closely reflects the level of effort related to the Company's performance under the arrangement. Direct costs are those costs that directly result in the culmination of an earnings process for which the counterparty to the arrangement receives a direct benefit. The nature of these costs are third party and internal costs associated with conducting clinical trial activities, allocated payroll related costs for representatives participating on the joint steering committee and sales and marketing costs during the co-commercialization period. Direct costs specifically exclude costs that are of a general and administrative nature.

Amounts resulting from payments received in advance of revenue recognized are recorded as deferred revenue.

The Company is required to assess the profitability of the overall arrangement on a periodic basis throughout the life of the arrangement when events or circumstances indicate a potential change in facts. Such assessment is based on estimates to determine the most likely outcome based on available facts and circumstances at each assessment date. The estimates include the consideration of factors such as the progress and timing of clinical trials, competition in the market, the development progress of other potential competitive therapies, drug related serious adverse events and other safety issues in the clinical trials, pricing reimbursement in relevant markets and historical costs incurred compared to original estimates. When the periodic assessment or other events or circumstances indicate a loss will result from performance under the arrangement, the entire amount of the loss is charged to the statement of comprehensive consolidated income (loss) in the period in which the determination is made.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 *(In Canadian dollars)*

2.17 Research and development

Research and development expenses include salaries, share-based payments, clinical trial costs, manufacturing and research inventory. Research and development expenditure is charged to the consolidated statement of comprehensive income (loss) in the period in which it is incurred. Development expenditure is capitalized when the criteria for recognizing an asset are met.

Research inventories

Inventories consist of materials that are used in future studies and clinical trials, and are measured at the lower of cost and net realizable value. Net realizable value is measured at the estimated selling price of the inventory less estimated costs of completion and estimated costs to make the sale. The amount of the write-down of inventories is included in research and development expense in the period the loss occurs, which is currently at the time the inventory is acquired since the Company does not intend to sell the material used in studies and clinical trials.

2.18 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are expensed on a straight-line basis over the term of the lease.

2.19 IFRS issued but not yet adopted

IFRS 36 – Impairment of Assets

IAS 36 has been amended to include limited scope amendments to the impairment disclosures. The amendments are effective for annual periods beginning on or after January 1, 2014. The Company has not determined the impact of the adoption of this IFRS on the Company's consolidated financial statements.

IFRS 2 – Share Based Payments

IFRS 2 has been amended to clarify the definition of vesting conditions. The amendments are effective for annual periods beginning on or after July 1, 2014. The Company has not determined the impact of the adoption of IFRS 2 on the Company's consolidated financial statements.

IAS 15 – Revenue from Contracts with Customers

IFRS 15 specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with some informative, relevant disclosures. The standard supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts. IFRS 15 must be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2017 and early adoption is permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the consolidated financial statements in conformity with IFRS requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company bases its estimates and judgments on historical experience and on various other assumptions that it considers to be reasonable. The resulting accounting estimates will, by definition, seldom equal the related actual results. Actual results may differ from these estimates under different assumptions or conditions.

The most significant estimates and judgments included in these consolidated financial statements are the evaluation of the profitability of a revenue contract, the valuation and amortization of intangible assets, valuation of contingent consideration payable and share-based payments.

a) Estimates

Valuation and Amortization of Intangible Assets

The Company's intangible assets are comprised of purchased or licensed pharmaceutical compounds, technology and patents. The costs of the Company's intangible assets are amortized over the estimated useful life of 20 years. Factors considered in estimating the useful life of the intangible asset include the expected use of the asset by the Company, legal, regulatory and contractual provisions that may limit the useful life, the effects of competition and other economic factors, and the level of expenditures required to obtain the expected future cash flows from the intangible asset. The Company re-evaluates the useful life when there has been a change in these factors. See note 7 for additional information on changes in useful life and impairments. The Company assesses its intangible assets for recoverability whenever indicators of impairment exist. When the carrying value of an asset is greater than its recoverable amount, which is the higher of its value in use or fair value less costs to sell, an impairment loss is recognized.

Valuation of Contingent Consideration Payable

The contingent consideration is measured at fair value based on level 3 inputs. The contingent consideration is not based on observable inputs and is measured using a discounted cash flow analysis of expected payments in future periods. The significant estimates used in the fair value calculations are as follows:

- (a) Management has estimated the timing of the milestone payments based on current expectations and plans for the development of ELND005. The milestone payments are assigned a probability based on industry statistics for the successful development of pharmaceutical products including regulatory approval and achievement of revenue targets. An increase of 10% applied to the probability assumptions, with all other variables held constant, will increase the contingent consideration payable by \$1,173,000. Conversely a decrease of 10% applied to the probability assumptions, with all other variables held constant, would decrease the contingent consideration payable by \$1,173,000;
- (b) The probability adjusted cash flows are discounted at a rate of 22.7% which is management's best estimate of the Company's cost of capital. An increase of 5% to the discount rate would decrease the contingent consideration payable by \$885,502. Conversely, a decrease of 5% to the discount rate would increase the contingent consideration payable by \$1,215,524.

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June 30, 2014 *(In Canadian dollars)*

Share Based Payments and Warrants

When the Company issues stock options and warrants, an estimate of fair value is derived for the equity instrument using the Black-Scholes option pricing model. The application of this option pricing model requires management to make assumptions regarding several variables, including the period for which the instrument will be outstanding, the price volatility of the Company's stock over a relevant timeframe, the determination of a relevant risk free interest rate and an assumption regarding the Company's dividend policy in the future. If other assumptions are used, the value derived for the equity instruments could be significantly impacted.

b) Judgments

Recognition of Revenue

As a result of the Company's amendment to the collaboration agreement with Elan, the Company has recognized as revenue in fiscal 2013 all amounts that have been received under the contract. The recognition of revenue requires judgment in evaluating the contractual terms and assessing the Company's performance towards meeting the contractual obligations.

Settlement of a Pre-Existing Relationship

The Company has determined that the transactions entered into with Perrigo Company plc on February 28, 2014 have resulted in the re-acquisition of the rights for the development and commercialization of ELND005 previously licensed to Elan Pharmaceuticals plc ("Elan") which in accordance with IFRS must be accounted for as a settlement of a pre-existing relationship (the collaboration agreement between Waratah and Elan). Accordingly, the company has expensed \$3,096,186 during the year ended June 30, 2014 as the cost related to the settlement of the pre-existing relationship.

4. GLOBAL COLLABORATION AGREEMENT WITH PERRIGO COMPANY PLC

On December 18, 2013, Perrigo Company plc ("Perrigo") completed its acquisition of Elan and all its subsidiaries. With this acquisition, Perrigo acquired all the rights and obligations of Elan under the collaboration agreement with Waratah, a wholly owned subsidiary, for the development and commercialization of ELND005.

On February 28, 2014, through a series of transactions, the Company's newly obtained wholly owned Irish subsidiary, Transition Therapeutics Ireland Limited re-acquired all of the development and commercialization rights of the ELND005 drug candidate previously licensed to Elan. In addition, Perrigo is eligible to receive up to US\$40 million in approval and commercial milestone payments and 6.5% royalties on net sales of ELND005 products and sublicense fees received. The milestone payments meet the definition of a financial liability and accordingly, the Company has recorded the contingent consideration payable at fair value. The accounting for this transaction, in accordance with IFRS, required significant judgment. Based on management's review and assessment of the agreements entered into as well as the existing rights of the Company under the collaboration agreement with Elan, management determined that the transactions entered into resulted in the re-acquisition of the rights to the development and commercialization of ELND005 which in accordance with IFRS must be accounted for as a settlement of a pre-existing relationship (the collaboration agreement between Waratah and Elan). Accordingly, the Company has recognized a settlement on a pre-existing relationship in the amount of \$3,096,186 in the statement of income (loss).

In parallel with this acquisition, the Company issued 2,255,640 common shares for cash consideration of US\$15 million. The Company's Irish subsidiary will be responsible for all future development and commercialization activities of the ELND005 drug candidate.

5. FINANCIAL RISK MANAGEMENT

5.1 Categories of financial assets and liabilities

All financial instruments are measured at amortized cost except for the contingent consideration payable which is at fair value. The following table outlines the Company's financial instruments, their classification, carrying value and fair value.

| Financial Instruments as at June 30, 2014 | Classification | Carrying Value \$ | Fair Value \$ |
|--|------------------------------------|------------------------------|--------------------------|
| Cash | Loans and receivables | 57,212,004 | 57,212,004 |
| Short term investments | Loans and receivables | 3,059,562 | 3,059,562 |
| Accounts payable and accrued liabilities | Other liabilities | 5,963,258 | 5,963,258 |
| Contingent consideration payable | Fair value through profit and loss | 3,838,286 | 3,838,286 |

| Financial Instruments as at June 30, 2013 | Classification | Carrying Value \$ | Fair Value \$ |
|--|------------------------------------|------------------------------|--------------------------|
| Cash | Loans and receivables | 23,067,937 | 23,067,937 |
| Short term investments | Loans and receivables | 5,057,702 | 5,057,212 |
| Accounts payable and accrued liabilities | Other liabilities | 874,149 | 874,149 |
| Contingent consideration payable | Fair value through profit and loss | 3,756,331 | 3,756,331 |

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. Fair value of cash equivalents and short term investments is determined based on a valuation model that uses daily pricing reports to determine the amount the holder would receive if the instrument were sold on that day. The fair value of the contingent consideration payable is determined using a valuation model as discussed in note 3.

5.2 Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange and interest rate risks), credit risk and liquidity risk. Risk management is the responsibility of the Company's finance function which identifies, evaluates and where appropriate, mitigates financial risks.

(a) Market risk

(i) Foreign exchange risk

The Company operates in Canada and has relationships with entities in other countries. Foreign exchange risk arises from purchase transactions, as well as recognized financial assets and liabilities denominated in foreign currencies, mainly the US dollar. The Company does not enter into hedging or other contracts to mitigate its exposure to foreign exchange risk and maintains sufficient US dollars to meet the Company's planned US dollar expenses.

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Balances in foreign currencies at June 30, 2014 and 2013 are approximately:

| | 2014 US\$ | 2013 US\$ |
|---------------------------|--------------|--------------|
| Cash and cash equivalents | 48,722,203 | 15,953,520 |
| Trade and other payables | (711,490) | (336,561) |
| | 48,010,713 | 15,616,959 |

Fluctuations in the US dollar exchange rate could potentially have a significant impact on the Company's results. At June 30, 2014, if the Canadian dollar weakened 10% against the US dollar, with all other variables held constant, comprehensive income for the year ended June 30, 2014 would have increased by approximately \$2,166,000. Conversely, if the Canadian dollar strengthened 10% against the US dollar, with all other variables held constant, comprehensive income for the year ended June 30, 2014 would have decreased by approximately \$2,166,000.

(ii) Interest rate risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's cash and cash equivalents and short term investments which are at a fixed rate of interest and accordingly are not exposed to changes in market interest rates, however, their fair value can vary with the change in market interest rates.

Although the Company monitors market interest rates, the Company's investment policies are designed to maintain safety of principal and provide adequate liquidity to meet all current payment obligations and future planned expenditures. The Company does not speculate on interest rates and holds all deposits until their date of maturity.

Interest income from cash, cash equivalents and short term investments was \$219,273 for the year ended June 30, 2014 (2013 - \$144,432).

(b) Credit risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The Company's exposure to credit risk at the period end is the carrying value of its cash and cash equivalents and short term investments.

The Company manages credit risk by maintaining bank accounts with financial institutions of high creditworthiness and investing in cash and cash equivalents with maturities less than 90 days and ratings of R-1 or higher. Short term investments consist of bankers' acceptances and other debentures maturing in less than 12 months and ratings of R-1 or higher.

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they become due.

The Company's investment policies are designed to maintain safety of principal and provide sufficient readily available cash in order to meet liquidity requirements. The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. All cash and cash equivalents and short term investments have maturities less than one year.

At June 30, 2014 the Company's financial liabilities which include trade and other payables are current and are expected to be repaid within 1 to 3 months of the period end date.

The contingent consideration payable is expected to be paid as follows:

| | |
|----------------------------------|--------------|
| Fiscal year ending June 30, 2016 | \$2,847,759 |
| Fiscal year ending June 30, 2020 | \$10,670,000 |
| Fiscal year ending June 30, 2021 | \$19,802,096 |
| Fiscal year ending June 30, 2022 | \$20,276,664 |

5.3 Capital risk management

The Company's primary objective when managing capital is to ensure its ability to continue as a going concern in order to pursue the development of its drug candidates and the out-license of these drug candidates to pharmaceutical companies. The Company attempts to maximize return to shareholders by minimizing shareholder dilution and, when possible, utilizing non-dilutive funding arrangements such as interest income and collaborative partnership arrangements.

The Company includes equity comprised of issued share capital, warrants, contributed surplus and deficit in the definition of capital. The Company has financed its capital requirements primarily through share and warrant issuances since inception and collaborative partnership agreements.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and risk characteristics of the underlying assets. The Company monitors its cash requirements and market conditions to anticipate the timing of requiring additional capital to finance the development of its drug candidates. The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital management strategy during the year ended June 30, 2014 from the year ended June 30, 2013.

The Company's current cash projection indicates that the current cash resources should enable the Company to execute its core business plan and meet its projected cash requirements beyond the next 12 months. However, the Company's working capital may not be sufficient to meet its stated business objectives in the event of unforeseen circumstances or a change in the strategic direction of the Company. When, or if, the Company requires additional capital, there can be no assurance that the Company will be able to obtain further financing on favourable terms, if at all.

6. SHORT TERM INVESTMENTS

Short term investments consist of two medium term note debentures totaling \$3,059,562 at June 30, 2014 [June 30, 2013 – \$5,057,702] with ratings of R1 or higher and maturity dates of October 23, 2014 and November 28, 2014. There were no gains or losses realized on the disposal of the short term investments during the years ended June 30, 2014 and 2013 as all the financial assets were held to their redemption date. The maximum exposure to credit risk at the reporting date is the carrying amount of cash and cash equivalents and short term investments.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

7. INTANGIBLE ASSETS

Intangible assets consist of the following:

| | Technology acquired (ELND005) \$ | Lilly Licenses acquired (TT401/402) \$ | Total \$ |
|-------------------------------------|---|--|------------------|
| As at July 1, 2013 | | | |
| Cost | 20,547,993 | 1,055,900 | 21,603,893 |
| Accumulated amortization | (12,488,792) | (176,427) | (12,665,219) |
| Net book value | 8,059,201 | 879,473 | 8,938,674 |
| As at June 30, 2014 | | | |
| Cost | 20,547,993 | 1,055,900 | 21,603,893 |
| Accumulated amortization | (13,367,489) | (229,223) | (13,596,712) |
| Net book value June 30, 2014 | 7,180,504 | 826,677 | 8,007,181 |
| Year ended June 30, 2014 | | | |
| Opening net book value | 8,059,201 | 879,473 | 8,938,674 |
| Amortization charge | (878,697) | (52,796) | (931,493) |
| Net book value June 30, 2014 | 7,180,504 | 826,677 | 8,007,181 |

| | Technology acquired (ELND005) \$ | NMX Compounds acquired (TT301/302) \$ | Lilly Licenses acquired (TT401/402) \$ | Total \$ |
|---|---|---|--|------------------|
| As at July 1, 2012 | | | | |
| Cost | 20,547,993 | 11,085,259 | 1,055,900 | 32,689,152 |
| Accumulated amortization | (11,501,321) | (3,800,410) | (123,631) | (15,425,362) |
| Net book value | 9,046,672 | 7,284,849 | 932,269 | 17,263,790 |
| As at June 30, 2013 | | | | |
| Cost | 20,547,993 | 11,085,259 | 1,055,900 | 32,689,152 |
| Accumulated amortization and impairment | (12,488,792) | (11,085,259) | (176,427) | (23,750,478) |
| Net book value June 30, 2013 | 8,059,201 | - | 879,473 | 8,938,674 |
| Year ended June 30, 2013 | | | | |
| Opening net book value | 9,046,672 | 7,284,849 | 932,269 | 17,263,790 |
| Amortization charge | (987,471) | (739,028) | (52,796) | (1,779,295) |
| Impairment charge | - | (6,545,821) | - | (6,545,821) |
| Net book value June 30, 2013 | 8,059,201 | - | 879,473 | 8,938,674 |

In light of the series of agreements the Company entered into with Perrigo Company plc relating to the ELND005 technology, management reviewed the estimate of the remaining useful life of the ELND005 technology and extended the remaining useful life to 12 years. Accordingly, the change in estimate resulted in a decrease in amortization expense of \$108,774 being recognized during the year ended June 30, 2014.

During the year ended June 30, 2013, the Company decided to no longer develop TT301 and TT302, the compounds acquired from NMX. As the Company no longer expects to receive any benefits from the technology, the Company assessed the compounds for impairment and determined that the recoverable amount of the compounds was nil at June 30, 2013. Accordingly, the Company recognized an impairment loss of \$6,545,821 for the year ended June 30, 2013. The Company has terminated the licensing agreement with Northwestern University and has no further commitments relating to this technology.

The amortization of all intangible assets relates to the research and development efforts of the Company and has therefore been included in the “research and development” line in the consolidated statement of comprehensive income (loss).

8. TRADE AND OTHER PAYABLES

Trade and other payables consist of the following:

| | June 30, 2014 \$ | June 30, 2013 \$ |
|------------------|---------------------|---------------------|
| Accounts payable | 1,591,128 | - |
| Accrued expenses | 4,372,130 | 874,149 |
| | 5,963,258 | 874,149 |

9. CONTINGENT CONSIDERATION PAYABLE

- (a) Under the terms of the ENI step-acquisition agreement, the Company is committed to pay the former shareholders of ENI contingent clinical milestones potentially totaling \$10.9 million payable in cash or Transition common shares at the then market price and a royalty of up to 1% on net sales of the ELND005 product. The contingent consideration is required to be measured as a financial liability at fair value and re-measured at each reporting date. On February 28, 2014, the Company became responsible for the development of ELND005 and accordingly has re-evaluated the development program timelines and adjusted the estimate relating to the timing of the milestone payments. Accordingly, the Company has recognized a liability as at June 30, 2014 of \$1,030,775 (June 30, 2013 - \$3,756,331) which represents the fair value of the contingent consideration payable to the former shareholders of ENI.
- (b) Under the terms of the ELND005 milestone and royalty agreement, the Company is committed to pay Perrigo contingent approval and commercialization milestones potentially totaling US\$40 million and a royalty of up to 6.5% on net sales of the ELND005 product. The contingent consideration is required to be measured as a financial liability at fair value and re-measured at each reporting date. Accordingly, the Company has recognized a liability as at June 30, 2014 of \$2,807,511 (June 30, 2013 - nil) which represents the fair value of the contingent consideration payable to Perrigo (note 4).

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

| Contingent Consideration Payable | Payable to ENI \$ | Payable to Perrigo \$ | Total \$ |
|--|----------------------------------|--------------------------------------|---------------------|
| Balance at beginning of period | 3,756,331 | - | 3,756,331 |
| Settlement of pre-existing relationship | - | 3,096,186 | 3,096,186 |
| Change in contingent consideration payable | (2,725,556) | (185,662) | (2,911,218) |
| Foreign exchange | - | (103,013) | (103,013) |
| Balance at end of period | 1,030,775 | 2,807,511 | 3,838,286 |

Significant assumptions and the sensitivity of changes to these assumptions are discussed in Note 3.

10. LICENSING AND COLLABORATION AGREEMENT WITH ELI LILLY AND COMPANY

- (a) On March 3, 2010, Transition and Eli Lilly and Company (“Lilly”) entered into a licensing and collaboration agreement granting Transition the rights to a series of preclinical compounds in the area of diabetes. Under the licensing and collaboration agreement, Transition will receive exclusive worldwide rights to develop and potentially commercialize a class of compounds that, in preclinical models showed potential to provide glycemic control and other beneficial effects including weight loss.

Under the terms of the agreement, Lilly received an up-front payment of US\$1 million and retained the option to reacquire the rights to the compounds at a later date. The up-front payment of \$1,055,900 (US\$1 million) has been capitalized as a license acquired from Lilly and will be amortized over 20 years which represents the estimated remaining life of the underlying compounds and patents.

In June 2013, Lilly exercised their option and assumed all development and commercialization rights to type 2 diabetes drug candidate TT401. In conjunction with this assumption of rights, Transition received a milestone payment of \$7,118,300 (US\$7 million) which has been recognized as revenue during the year ended June 30, 2013. Lilly has assumed all costs and will perform all future development and commercialization activities of TT401, and Transition will pay US\$14 million to Lilly in three separate installments during the Phase 2 clinical study. In return, Transition is eligible to receive up to approximately US\$240 million in additional milestone payments and will also be eligible to receive a double-digit royalty on sales of TT401 products and a low single digit royalty on related compounds. Subsequent to June 30, 2014, the Company paid Lilly the first instalment of US\$6 million. (See note 21).

- (b) On July 23, 2013, the Company entered into an exclusive licensing agreement with Lilly for the worldwide rights to develop and potentially commercialize a novel small molecule transcriptional regulator (“TT601”) for the treatment of osteoarthritis pain.

On April 7, 2014, the Company announced there would be no further development of TT601. This decision was made after expanded toxicology study data and regulatory interactions revealed the development plan would be restricted and timelines delayed. Under the terms of the agreement with Lilly, the rights to TT601 have been returned to Lilly and the Company has no further funding obligations to Lilly for the development of TT601.

11. SHARE CAPITAL

[a] Authorized

At June 30, 2014, the authorized share capital of the Company consists of an unlimited number of no par value common shares. The common shares are voting and are entitled to dividends if, as and when declared by the Board of Directors.

[b] Common shares issued and outstanding during the period

On August 15, 2013, the Company announced the closing of its private placement financing issuing 2,625,300 units of the Company to existing shareholders, board members and management at a price of US\$4.19 per unit, raising gross proceeds of \$11,439,000 (US\$11.0 million). Each unit consists of (i) one common share, (ii) 0.325 Common Share purchase warrant with a purchase price of US\$4.60 per whole warrant and (iii) 0.4 Common Share purchase warrant with a purchase price of US\$6.50 per whole warrant. The Company incurred total share issuance costs of \$521,000, resulting in net cash proceeds of approximately \$10,918,000.

On February 28, 2014, the Company issued 2,255,640 common shares to a subsidiary of Perrigo for gross proceeds of \$16,422,000 (US\$15.0 million). The Company incurred total share issuance costs of \$59,000, resulting in net cash proceeds of approximately \$16,363,000.

On June 23, 2014, the Company announced the closing of its private placement financing issuing 3,195,487 units of the Company to existing shareholders, board members and management at a price of US\$5.32 per unit, raising gross proceeds of \$18,319,000 (US\$17.0 million). Each unit consists of one common share and 0.61 Common Share purchase warrant with a purchase price of US\$7.10 per whole warrant. The Company incurred total share issuance costs of \$106,000, resulting in net cash proceeds of approximately \$18,213,000.

At June 30, 2014, there were 35,303,913 common shares issued and outstanding [June 30, 2013 – 26,930,634].

Warrants

In connection with the Company's August 15, 2013 private placement, the Company issued 853,223 full warrants with a purchase price of US\$4.60 and 1,050,118 full warrants with a purchase price of US\$6.50. Each whole warrant will entitle the holder, within two years of the closing date, to purchase one additional common share in the capital of the Company.

The Company's June 23, 2014 private placement issued 1,949,250 full warrants with a purchase price of US\$7.10. Each whole warrant will entitle the holder, within two years of the closing date, to purchase one additional common share in the capital of the Company.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

Details of whole warrants outstanding at June 30, 2014 are as follows:

| Warrants | # | Fair Value \$ | Expiry Date |
|---|------------------|------------------|-----------------|
| Balance at beginning of period | - | - | |
| US\$4.60 Warrants issued at August 15, 2013 | 853,223 | 1,108,107 | August 15, 2015 |
| US\$6.50 Warrants issued August 15, 2013 | 1,050,118 | 917,732 | August 15, 2015 |
| US\$7.10 Warrants issued June 23, 2014 | 1,949,250 | 3,150,558 | June 23, 2016 |
| Warrants outstanding June 30, 2014 | 3,852,591 | 5,176,397 | |

If and when all of the warrants are exercised, the Company may realize up to an additional US\$24.5 million in proceeds.

The outstanding warrants at June 30, 2014 have a total fair value of \$5,176,397 which was calculated using the Black-Scholes pricing model with the following assumptions:

| Warrants Issued | August 15, 2013 | June 23, 2014 |
|---------------------------|-----------------|---------------|
| Risk free interest rate | 1.18% | 1.03% |
| Expected dividend yield | 0% | 0% |
| Stock price volatility | 0.6348 | 0.6694 |
| Expected life of warrants | 2.0 years | 2.0 years |

[c] Stock Options

| Stock options | # | \$ | Weighed Average Exercise Price \$ |
|---|------------------|------------------|---|
| Stock options outstanding, July 1, 2013 | 1,872,000 | 2,352,002 | 2.97 |
| Stock options issued [i] | 742,000 | - | 6.12 |
| Stock options exercised [ii] | (296,852) | (623,617) | 3.59 |
| Stock options forfeited or cancelled [iv] | (11,559) | (219) | 2.82 |
| Stock based compensation expense | - | 1,138,126 | - |
| Stock options outstanding, June 30, 2014 | 2,305,589 | 2,866,292 | 3.91 |

| Stock options | # | \$ | Weighed Average Exercise Price \$ |
|---|-----------|-------------|---|
| Stock options outstanding, July 1, 2012 | 1,949,919 | 2,977,032 | 4.10 |
| Stock options issued [i] | 325,000 | - | 3.64 |
| Stock options exercised [ii] | (9,332) | (13,668) | 2.10 |
| Stock options expired [iii] | (210,920) | (1,190,334) | 13.62 |
| Stock options forfeited or cancelled [iv] | (182,667) | (409,257) | 3.56 |
| Stock based compensation expense | - | 988,229 | - |
| Stock options outstanding, June 30, 2013 | 1,872,000 | 2,352,002 | 2.97 |

- [i] The fair value of the stock options issued during the year ended June 30, 2014 was \$3,346,000 [2013 - \$853,800].
- [ii] During the year ended June 30, 2014, 296,852 stock options were exercised. These stock options had a fair value of \$623,617 at the grant date and resulted in cash proceeds to the Company of \$1,065,757.

During the year ended June 30, 2013, 9,332 stock options were exercised. These stock options had a fair value of \$13,668 at the grant date and resulted in cash proceeds to the Company of \$19,597.

- [iii] During the comparative year ended June 30, 2013, 210,920 stock options expired unexercised. These stock options had a fair value of \$1,190,334 which was reclassified to contributed surplus.
- [iv] During the year ended June 30, 2014, 11,559 stock options were forfeited or cancelled, of which 83 were fully vested. The vested options had a fair value of \$219 which has been reclassified to contributed surplus.

In the year ended June 30, 2013, 182,667 stock options were forfeited or cancelled, of which 178,000 were fully vested. The vested options had a fair value of \$409,257 which has been reclassified to contributed surplus.

- [v] The maximum possible cash proceeds to the Company from the exercise of the stock options outstanding at June 30, 2014 are \$9,005,578 [June 30, 2013 - \$5,563,736].

12. STOCK-BASED COMPENSATION PLANS

The Company's stock option plan is designed to attract and retain key individuals and recognize individual and overall corporate performance. In terms of performance, the Company's policy is to establish annual goals with respect to business strategy and the individual's area of direct responsibility. The Company grants options to its employees at the time when they join the organization and then subsequent grants are issued at the discretion of the Board of Directors. Grants issued are based on the level of the position that the employee is hired for and their overall experience and subsequent grants are based on the level of position, the Company's performance, and the employee's performance. Stock option grants are approved by the Board of Directors. The Board of Directors considers the amount and the terms of outstanding options when determining whether and how many new option grants will be made.

Options granted to employees generally vest monthly or annually over a 3 to 4 year period. The exercise price of the options is equal to the greater of (1) the closing price the day prior to the grant; (2) the weighted average trading price for five trading days prior to grant; and (3) the price determined by the Board of Directors at the time of the grant. All grants expire 10 years after the grant date or generally terminate 3 to 6 months after the employee leaves the Company depending on the circumstances of their departure.

The fair value of each option award is estimated on the date of the grant using the Black-Scholes option pricing model. The expected volatilities have been computed based on trailing 8 year historical share price trading data of week ending closing prices. The risk-free rate is based on the 8 year Government of Canada marketable bond rates in effect at the time of the grants. The expected life of the option is estimated to be 8 years based on historical option exercising patterns.

In November 1999, the Company established a Stock Option Plan [the "Plan"] for the directors, officers, employees, members of the Scientific Advisory Board and consultants of the Company or of subsidiaries of the Company in order to secure for the Company and its shareholders the benefit of an incentive interest in share ownership by participants under the Plan. The Plan is administered by the Board of Directors of the Company.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

In December 2005, the shareholders voted to amend the stock option plan of the Company to change the maximum number of common shares available for issuance under the stock option plan from a fixed number to a rolling number equal to 10% of the then issued and outstanding common shares of the Company, from time to time.

In December 2008, the shareholders voted to approve and reaffirm the unallocated options under the plan as required every three years and also voted to amend the stock option plan of the Company to (i) extend the time for exercising an option if the expiry date is during a Black-Out Period, and (ii) include amending procedures that specify which Stock Option Plan changes require shareholder approval.

During fiscal 2011, the Board of Directors amended the Stock Option Plan so that all options granted after December 7, 2010 expire in 10 years. Options granted prior to this date expire in 5 years.

The Stock Option Plan was not re-approved at the 2011 annual meeting of the Company and as a result, in December, 2012, shareholders voted in favour of approving 684,000 options granted to management, directors and employees outside of the plan. Shareholders also voted to reapprove and reaffirm the unallocated options under the plan as required every three years.

All stock options granted under the Plan must be exercised within a maximum period of ten years following the grant date thereof. The maximum number of common shares that may be issued pursuant to stock options granted under the Plan shall not exceed 10% of the issued and outstanding common shares. As at June 30, 2014, there are 1,224,802 options available for issuance under the Plan. The maximum number of common shares that may be issued to any individual pursuant to stock options granted under the Plan will not exceed 5% of the outstanding common shares and the total number of common shares that may be issued to consultants pursuant to stock options granted under the Plan will not exceed 2% of the issued and outstanding common shares in any twelve month period. The vesting period is determined at the time of each option grant but must not exceed five years.

A summary of options outstanding as at June 30, 2014 under the plans are presented below:

| Range of exercise prices \$ | Outstanding | | | Exercisable | | |
|--------------------------------|------------------------|--|---------------------------------------|------------------------|--|---------------------------------------|
| | Number of options # | Weighted average remaining contractual life [years] | Weighted average exercise price \$ | Number of options # | Weighted average remaining contractual life [years] | Weighted average exercise price \$ |
| 2.09-2.10 | 658,174 | 7.93 | 2.10 | 455,544 | 7.94 | 2.10 |
| 3.00-3.22 | 403,187 | 6.92 | 3.19 | 315,610 | 6.93 | 3.18 |
| 3.42-3.66 | 502,228 | 6.08 | 3.58 | 299,524 | 4.11 | 3.54 |
| 6.00-7.67 | 742,000 | 9.96 | 6.12 | - | - | - |
| | <u>2,305,589</u> | | | <u>1,070,678</u> | | |

A summary of options outstanding as at June 30, 2013 under the plans are presented below:

| Range of exercise prices \$ | Outstanding | | | Exercisable | | |
|--------------------------------|------------------------|--|---------------------------------------|------------------------|--|---------------------------------------|
| | Number of options # | Weighted average remaining contractual life [years] | Weighted average exercise price \$ | Number of options # | Weighted average remaining contractual life [years] | Weighted average exercise price \$ |
| 2.09-2.10 | 730,000 | 8.93 | 2.10 | 267,403 | 8.93 | 2.10 |
| 3.00-3.22 | 442,000 | 7.92 | 3.19 | 258,909 | 7.93 | 3.17 |
| 3.42-3.66 | 510,000 | 7.12 | 3.58 | 151,232 | 2.09 | 3.48 |
| 4.15-4.29 | 190,000 | 0.97 | 4.18 | 190,000 | 0.97 | 4.18 |
| | <u>1,872,000</u> | | | <u>867,544</u> | | |

For the year ended June 30, 2014, total stock based compensation expense was \$1,138,126 [2013 - \$988,229], split between general and administrative expense of \$636,531 [2013 - \$579,291] and research and development of \$501,595 [2013 - \$408,938].

The fair value of options granted during fiscal 2014 is \$3,346,000 [2013 - \$853,800]. The fair value of the options at the date of grant for the year ended June 30, 2014 was estimated using the Black-Scholes option pricing model based on the following assumptions: expected option life of 8 years [2013 - 8 years], volatilities of 0.7679 and 0.7691 [2013 - 0.743], risk free interest rate of 1.79% [2013 - 1.75%] and a dividend yield of 0% [2013 - 0%].

The weighted average grant date fair value of options granted during the year ended June 30, 2014 was \$4.51 [2013 - \$2.63].

As at June 30, 2014 and 2013, total compensation cost related to non-vested awards not yet recognized is \$3,282,863 and \$1,202,255, respectively. The weighted average period over which it is expected to be recognized is 32 and 28 months respectively.

For fiscal 2014, the weighted average exercise price and the weighted average remaining contractual life of the outstanding stock options are \$3.91 and 8.01 years [2013 - \$2.97 and 7.39 years]. The weighted average exercise price and the weighted average remaining contractual life of the exercisable stock options are \$2.82 and 6.57 years [2013 - \$3.11 and 5.70 years].

The intrinsic value of options exercised during fiscal 2014 is \$506,341 [2013 - \$17,596] and the intrinsic value of options granted for fiscal 2014 and 2013 is nil.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 *(In Canadian dollars)*

13. INCOME TAXES

- [a] As at June 30, 2014, the Company has total non-capital losses of approximately \$64,969,000 [2013- \$50,544,000] available for carry forward to reduce future taxable income in Canada, the United States of America and Ireland. The non-capital losses will begin to expire as follows:

| | \$ |
|------|-------------------|
| 2015 | 3,407,000 |
| 2026 | 4,547,000 |
| 2027 | 5,239,000 |
| 2028 | 4,470,000 |
| 2029 | 5,481,000 |
| 2030 | 10,453,000 |
| 2031 | 5,677,000 |
| 2032 | 6,565,000 |
| 2033 | 925,000 |
| 2034 | 18,205,000 |
| | <u>64,969,000</u> |

As at June 30, 2014, the Company also has approximately \$40,243,000 [2013 - \$37,915,000] in Canadian scientific research and experimental development expenditures which can be carried forward indefinitely to reduce future years' taxable income. During fiscal 2014 the Company recorded \$193,000 [2013 - \$293,000] of refundable provincial ITCs which was recorded as a reduction to research and development, net. The Company has approximately \$9,044,000 [2013 - \$8,985,000] in federal ITCs and \$700,000 [2013 - \$707,000] of non-refundable Ontario Research Development Tax Credits that can be carried forward for up to twenty years and used to reduce the Company's taxes payable.

- [b] Significant components of the Company's unrecognized deferred tax assets and deferred tax liabilities are as follows:

| | 2014 \$ | 2013 \$ |
|--|-------------------|-------------------|
| Deferred tax assets not recognized | | |
| Capital and intangible assets | 2,098,064 | 2,090,269 |
| Non-capital loss carryforwards | 16,470,897 | 12,855,338 |
| Canadian scientific research and experimental development expenditures | 10,664,292 | 10,047,349 |
| Investment tax credits | 7,321,900 | 7,881,020 |
| Contingent consideration payable | 624,094 | 995,428 |
| Financing and share issuance costs | 175,602 | 45,212 |
| Loss on disposal of SCT shares | 33,681 | 33,681 |
| Total deferred tax assets not recognized | 37,388,530 | 33,948,297 |
| Deferred tax assets and liabilities | | |
| Intangible assets | (284,718) | (531,563) |
| Leasehold inducement | (3,028) | (6,058) |
| Non-capital loss carryforwards | 287,746 | 537,621 |
| Net deferred tax liability | - | - |

- [c] The reconciliation of income tax attributable to continuing operations computed at the statutory tax rates to income tax recovery is as follows:

| | 2014 \$ | 2013 \$ |
|---|-------------|------------|
| Tax expense (recovery) at combined federal and provincial rates of 26.5% (2013 – 26.5%) | (5,772,298) | 6,174 |
| Non-deductible permanent differences: | | |
| Stock-based compensation | 301,603 | 261,881 |
| Other permanent and non-deductible items | 6,831 | 8,576 |
| Difference in foreign tax rates | 889,481 | - |
| Deferred tax assets (recognized) not recognized for accounting | 4,574,383 | (276,631) |
| | - | - |

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

14. EXPENSES BY NATURE

| | 2014 \$ | 2013 \$ |
|--|------------|------------|
| Research and development | | |
| Clinical trials and manufacturing | 13,327,761 | 5,084,737 |
| Salaries and benefits | 2,432,519 | 1,506,136 |
| Amortization | 937,441 | 1,803,037 |
| Stock compensation expense | 501,595 | 408,938 |
| Facility lease costs and utilities | 196,307 | 176,153 |
| Insurance | 85,825 | 90,475 |
| General laboratory supplies and materials | 132,493 | 86,288 |
| Ontario investment tax credits | (246,556) | (292,892) |
| | 17,367,385 | 8,862,872 |
| Selling, general and administrative expenses | | |
| Salaries and benefits | 1,601,891 | 1,569,777 |
| Professional fees and services | 987,997 | 394,549 |
| Insurance | 223,943 | 250,252 |
| Stock compensation expense | 636,531 | 579,291 |
| Facility lease costs and utilities | 151,192 | 149,046 |
| Business development, corporate communication and investor relations | 798,954 | 354,511 |
| Regulatory and stock transfer fees | 138,975 | 94,481 |
| Office and related expenses | 177,635 | 148,821 |
| Amortization | 9,456 | 17,064 |
| | 4,726,574 | 3,557,792 |

15. EARNINGS (LOSS) PER SHARE

Basic and diluted loss per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of common shares outstanding during the year. The outstanding options to purchase common shares of 2,305,589 [June 30, 2013 – 1,872,000] are not included in the calculation of diluted earnings per share as the effect is anti-dilutive due to the losses incurred in the period or the average price per common share was in excess of the exercise price.

During the year ended June 30, 2014, the average share price was \$5.94. As a result, 853,223 warrants with a purchase price of US\$4.60 are in the money, but similar to options they have an anti-dilutive impact and are thus excluded from the calculation of diluted earnings per share.

For the year ended June 30, 2014 and 2013, 79,908 contingently returnable common shares were excluded from the basic and diluted net loss per common share calculation. The contingently returnable common shares relate to employment contracts and will be released from escrow based on the achievement of certain corporate milestones.

| | 2014 | 2013 |
|---|--------------|------------|
| Income (loss) attributable to equity holders of the Company | (21,782,255) | 23,297 |
| Weighted average number of common shares outstanding | 30,094,825 | 26,841,528 |

16. CONTINGENCIES AND COMMITMENTS

- [a] As at June 30, 2014, the Company is committed to aggregate expenditures of \$14,976,412 [2013 -\$14,732,000] under its collaboration agreements. In addition, at June 30, 2014, the Company is committed to aggregate expenditures of approximately \$13,613,000 [2013 - \$187,000] for clinical and toxicity studies to be completed during fiscals 2015 and 2016, approximately \$128,049 [2013 - \$244,000] for manufacturing agreements and approximately \$482,000 for consulting and other agreements [2013 – \$11,000].

Subsequent to June 30, 2014, the Company entered into manufacturing and clinical and toxicity study agreements aggregating approximately \$220,163.

- [b] The Company leases premises under an operating lease which originally expired on June 30, 2011 but the Company has elected to extend to 2015. The Company also sub-leases premises under an operating lease which expires on December 31, 2015. In addition, the Company leases photocopiers under operating leases that expire on various dates to March 2015. Future minimum annual lease payments under these operating leases, in aggregate and over the next five years are as follows:

| | \$ |
|------|----------------|
| 2015 | 235,705 |
| 2016 | 58,481 |
| 2017 | - |
| 2018 | - |
| 2019 | - |
| | <u>294,186</u> |

During the year, the rental expense for the various premises under operating leases was \$187,762 [2013 - \$163,660].

- [c] The Company's technology related commitments are as follows:

- [i] ELND005 Technology License:

The Company has a worldwide exclusive license to intellectual property relating to ELND005 with the inventor, an Alzheimer's disease researcher at the University of Toronto. Under the agreement, the inventor may receive milestone payments of up to \$150,000. For therapeutic products, a royalty of 2.5% will be due on the first \$100,000,000 of revenues received by the Company and 1.5% of revenues thereafter. For diagnostic products, a royalty of 10% will be due on the first \$100,000,000 of revenues received by the Company and 7% of revenues thereafter. Also, the inventor may receive up to \$25,000 for additional patent applications under this license. The agreement remains in force until the expiration of the last to expire patent.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014 (In Canadian dollars)

In addition, under the terms of the ENI acquisition agreement, the Company is committed to pay the former shareholders of ENI contingent clinical milestones potentially totaling \$10.9 million payable in cash or Transition common shares at the then market price and a royalty of up to 1% on net sales of ELND005 product (see note 9a).

In light of the series of transactions entered into on February 28, 2014, the Company is also committed to pay Perrigo Company plc up to US\$40,000,000 in approval and commercial milestone payments and 6.5% royalties on net sales of ELND005 products and sublicense fees received (see note 9b).

[ii] TT401 Diabetes Technology

TT401 is a dual agonist of the GLP-1 (Glucagon-Like Peptide-1) and glucagon receptors which is being developed to treat type 2 diabetes and accompanying obesity. In March 2010, Transition entered into a licensing and collaboration agreement with Eli Lilly and Company, where Transition acquired the rights to a series of pre-clinical compounds from Lilly, including TT401 for the treatment of type 2 diabetes.

In June, 2013, Lilly and Transition have amended their agreement to address future development of TT401 and associated financial arrangements. Lilly will assume all costs and perform all future development and commercialization activities of TT401. Transition will contribute payment of US\$14 million to Lilly in three separate installments during the Phase 2 clinical study. If TT401 is successfully commercialized, Transition will be eligible to receive approximately US\$240 million in additional milestone payments. Transition will also be eligible to receive a double-digit royalty on sales of TT401 products and a low single digit royalty on related compounds.

17. CHANGE IN WORKING CAPITAL

The change in working capital consists of the following:

| | 2014 \$ | 2013 \$ |
|-----------------------------------|------------|------------|
| Trade and other receivables | (186,493) | 7,866 |
| Investment tax credits receivable | (31,741) | 61,299 |
| Prepaid expenses and deposits | 322,508 | (42,878) |
| Trade and other payables | 5,153,165 | (304,766) |
| | 5,257,439 | (278,479) |

18. RELATED PARTY TRANSACTIONS

Key management compensation

Key management includes the Company's directors, and members of the senior management team. The compensation paid or payable to key management for employee services is shown below:

| | 2014 \$ | 2013 \$ |
|---|------------|------------|
| Salaries and other short-term employee benefits | 1,849,886 | 1,714,325 |
| Stock-compensation expenses | 964,237 | 860,897 |
| | 2,814,123 | 2,575,222 |

During fiscal 2014, the Company paid legal fees to a law firm where the Company's Secretary is a partner and to a corporation controlled by the Company's Secretary. Total fees and disbursements charged to the Company by these companies was \$4,000 [2013 – \$nil] and are included in general and administrative expenses. The balance owing at June 30, 2014 and 2013 is nil.

Members of the Company's Board of Directors, management and employees participated in both the August, 2013 and June, 2014 private placements. (See note 11)

These transactions occurred in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

19. GUARANTEES

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

20. SEGMENT DISCLOSURE

The Company operates in one operating segment, the research and development of therapeutic agents. Total revenue recognized during the comparative year ended June 30, 2013 amounted to \$17,933,500. The Company received \$10,815,200 from Elan Pharma International Limited, a company based in Ireland and received the balance of \$7,118,300 from Eli Lilly and Company, a company based in the United States of America.

21. SUBSEQUENT EVENTS

Under the terms of the Licensing and Collaboration Agreement with Lilly, Transition is required to pay US\$14 million in three separate installments to help fund the Phase 2 clinical study of diabetes drug candidate TT401. The first installment of US\$6 million is due when the clinical study achieves 20% patient enrollment. This clinical study milestone was achieved in August, 2014 and accordingly, the Company has paid Lilly US\$6 million subsequent to the year ended June 30, 2014.

BOARD OF DIRECTORS

Michael R. D. Ashton: Independent consultant to the pharmaceutical industry and former CEO of SkyePharma PLC

Paul Baehr: President, CEO and Chairman of IBEX Technologies Inc.

Dr. Tony Cruz: Chairman and CEO of Transition Therapeutics Inc.

Christopher Henley: President of Henley Capital Corporation

Dr. Gary W. Pace: Chairman and Founder of Sova Pharmaceuticals Inc., Founder, Director and former Chairman and CEO of QRxPharma Ltd.

CORPORATE INFORMATION

Corporate Office

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Toronto, Ontario, Canada M5G 1L7
Tel. 416-260-7770

Executive Officers

Dr. Tony Cruz, Chairman and CEO

Carl Damiani, COO

Nicole Rusaw, CFO

Dr. Aleksandra Pastrak, VP Clinical Development and Medical Officer

Dr. Bruce Connop, VP Non-Clinical & Pharmaceutical Development

Auditors

PricewaterhouseCoopers LLP
Toronto, Ontario, Canada

Transfer Agents

Canada:

Computershare Investor Services Inc.
Tel. 800-564-6253

USA:

Computershare Trust Company, NA
Tel. 303-262-0600

LEGAL COUNSEL

Securities:

Canada:

Michael J. Bennett, McCarthy Tétrault LLP

USA:

Brett Cooper, Orrick, Herrington & Sutcliffe LLP

CORPORATE SECRETARY

Louis Alexopoulos, Sotos LLP

ANNUAL GENERAL MEETING

December 9, 2014 @ 4:00 pm
MaRS Center, South Tower
101 College Street, Main floor, room CR3
Toronto, Ontario, Canada