

Management Discussion and Analysis of Financial Condition and Results of Operations (As of September 13, 2005)

This MD&A contains projections and other forward-looking statements regarding future events. Such statements are predictions, which may involve known and unknown risks, uncertainties and other factors, which could cause the actual events or results and company plans and objectives to differ materially from those expressed. For information concerning factors affecting the Company's business, the reader is referred to the documents that the Company files from time to time with applicable Canadian securities and regulatory authorities.

This discussion and analysis of the results of operations of Altachem Pharma Ltd. (“Altachem” or the “Company”) should be read in conjunction with the unaudited consolidated financial statements and accompanying notes for the six months ended July 31, 2005 and the audited consolidated financial statements for the years ended January 31, 2005 and January 31, 2004. This discussion and analysis provides an update to the discussion and analysis prepared for the year ended January 31, 2005. The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP) and have not been reviewed by the Company’s auditors. This discussion and analysis provides information on the operations of Altachem on a consolidated basis. All amounts are expressed in Canadian dollars unless otherwise noted and references to the term “year” refer to the fiscal year ended January 31st. Additional information related to the Company is on SEDAR at www.sedar.com.

Overview

Altachem is committed to the development and commercialization of new pharmaceutical products. It is developing a series of products for the treatment of cancer and other proliferative diseases based on its Sonolight and CDK platforms. It also has a profitable product in Accu-MAbTM, a monoclonal-based diagnostic kit for whooping cough. The Company also operates manufacturing facilities located in Edmonton, Alberta and Shanghai, China. These facilities are certified compliant with international recognized quality systems standards.

During the six month period ended July 31, 2005, the Company experienced numerous significant developments. Highlights are:

- a concentration of the Company’s efforts on drug development, with a special focus on the Company’s novel and proprietary photodynamic treatments for cancer and other proliferative diseases.
- a divesting of non-core assets.
- discontinuation of the Company’s operations in China. This discontinuance will involve a collapse of SACP and repatriation of SACP’s assets back to Canada and possibly a sale of the Shanghai-based manufacturing facility.

- a reconstitution of the Company's Scientific Advisory Board.
- the receipt of positive China testing results for Bionex hand gel disinfectant.
- the receipt of Health Canada approval to commence a Phase I clinical trial for HB Topical.
- the receipt of approval from the Australian Patent Office for the immunotherapy applications of hypocrellin derivatives.
- recapitalization of the Company. During the six months ended July 31, 2005, in a difficult financial market, the Company has attracted over \$2.7 million from a combination of equity, debenture, debt financing and government support programs and has thus been able to retire the bulk of its debt and begin to deploy new resources to program development.

The Company expects to incur significant expenditures on drug and product development in the next year. Altechem is also focusing on increasing revenue from manufacturing and product sales to cover drug and product development costs.

Manufacturing Operations

The previous strategy of Altechem's manufacturing operations was to provide positive cash flow to support drug and product development. However, net cash flowing from most of these activities has not met expectations so the Company has decided to divest all but the most profitable of these operations.

Therefore, on July 30, 2004, Altechem sold the assets associated with its contract manufacturing operations in Edmonton, Alberta for the sum of \$460,000. Altechem's Edmonton, Alberta manufacturing facility was primarily used to manufacture breath test kits under an agreement that was to expire in November 2007.

Edmonton, Alberta Manufacturing Facility

Altechem continues to maintain a manufacturing facility located in Edmonton, Alberta to manufacture Accu-MAb™, a whooping cough test kit sold by Altechem and which is profitable. This manufacturing facility is approximately 800 square feet, is equipped with clean room facilities and is certified compliant with internationally recognized quality systems standards, ISO 9001:2000 and ISO 13488 and CMDCAS (Health Canada's requirement for medical devices).

Shanghai, China Manufacturing Facility

Shanghai Hua Gao Pharmaceutical Pellet Core Company Ltd. ("SHGP") is a wholly owned foreign subsidiary of Altechem and is located in Shanghai, China. SHGP operates a 38,660 square foot manufacturing facility and a 9,100 square foot office building. SHGP has been audited and approved by the State Drug Administration in China and has been issued licenses by the Chinese Government to manufacture pharmaceutical pellet core and to manufacture Bionex

disinfectant. The manufacturing facility is designed to produce high quality, low cost products that meet both domestic and export quality standards. SHGP currently manufactures pharmaceutical pellet core and has a production line capable of manufacturing Bionex hard surface disinfectant.

Altachem is discontinuing operations in China and so the SHGP manufacturing facility is for sale. The Company has engaged with several parties who are conducting their due diligence on the facility.

Results of Operations

It is important to note that Altachem's net consolidated loss includes significant non-cash items. These non-cash items include amortization and options issued as consideration for services and options issued to employees. For the three and six months ended July 31, 2005, amortization was \$81,079 and \$177,928 respectively, options issued for services was \$47,885 for both periods and options issued to employees was \$1,000 and \$46,333, respectively. Net consolidated loss for the three and six months ended July 31, 2005 was \$640,509 or \$0.02 per share and \$1,455,179 or \$0.04 per share, respectively, on a fully diluted basis. For the three and six months ended July 31, 2004, net consolidated loss was \$1,231,733 or \$0.04 per share and \$2,235,539 or \$0.07 per share, respectively, on a fully diluted basis. After adjusting for non-cash items, cash flows used to fund operations for the three and six months ended July 31, 2005 were \$607,220 and \$1,813,907, respectively, as compared to \$1,220,638 and \$1,498,916, respectively, for the three and six months ended July 31, 2004.

Revenues

Prior to July 30, 2004, Altachem generated revenue from three sources: contract manufacturing of diagnostic test kits, sales of Accu-MABTM, a whooping cough diagnostic test kit and sales of pharmaceutical pellet core. On July 30, 2004 the Company has sold its assets relating to the contract manufacturing operations in Edmonton, Alberta. As a result, the Company no longer generates revenue from contract manufacturing of diagnostic breath test kits. The following table identifies the changes in revenue for the three and six months ended July 31, 2005 compared to the three and six months ended July 31, 2004.

Revenue	For the three months ended July 31			For the six months ended July 31		
	2005	2004	Increase (decrease)	2005	2004	Increase (decrease)
	\$	\$	\$	\$	\$	\$
Accu-MAB TM	32,450	23,822	8,628	80,671	67,494	13,177
Pharmaceutical pellet core	9,370	9,067	303	27,652	32,247	(4,595)
Total revenue from continuing operations	41,820	32,889	8,931	108,323	99,741	8,582
Revenue from discontinued operations	nil	36,955	(36,955)	nil	216,903	(216,903)

Sales of Accu-MABTM increased slightly for the three and six month periods ended July 31, 2005 compared to the three and six month periods ended July 31, 2004. The Company is looking to further expand sales of Accu-MABTM in Canada, the United States and to other countries. The

decrease in revenue in connection with the Company's discontinued operations is due to the Company sale of the contract manufacturing facility on July 30, 2004.

The direct costs associated with manufacturing are classified as materials, supplies and subcontracts expense. For continuing operations, materials, supplies and subcontracts expenses for the three and six month periods ended July 31, 2005 were \$9,293 and \$34,887, respectively, as compared to \$3,934 and \$29,507, respectively, for the three and six month periods ended July 31, 2004. The increase in direct costs is attributable to an increase in sales revenue over the corresponding periods.

Expenses

The following table identifies the changes in general and administrative expense for the three and six months ended July 31, 2005 compared to similar periods in the prior year.

General and administrative expenses	For the three months ended July 31			For the six months ended July 31		
	2005	2004	Increase (decrease)	2005	2004	Increase (decrease)
	\$	\$	\$	\$	\$	\$
Salaries, wages and benefits	107,655	83,875	23,780	315,322	493,730	(178,408)
Accounting/audit fees	5,073	2,210	2,863	5,083	20,017	(14,934)
Legal fees	25,294	183,221	(157,927)	46,100	269,263	(223,163)
Other support costs	41,633	53,414	(11,781)	138,961	86,641	45,814
Travel	7,929	14,555	(6,626)	23,002	50,208	(27,206)
Consulting	23,188	49,350	(26,162)	45,188	71,920	(26,732)
Rent	-	-	-	-	22,560	(16,054)
Insurance	7,106	16,313	(9,207)	17,985	32,626	(14,641)
Public company related costs	15,188	30,955	(15,767)	33,821	45,608	(11,787)
Total general and administrative expenses	233,066	433,893	(200,827)	625,462	1,092,573	(467,111)

Salaries, wages and benefits expense for the six months ended July 31, 2005 decreased due to the accrual in 2004 of amounts relating to the settlement agreements with two former officers/directors.

Legal fees for the three and six months ended July 31, 2005 decreased primarily from additional legal costs in 2004 associated with the preparing of information and legal assistance required for the Company's annual and special general meeting held on June 17, 2004.

General and Administrative expenses were generally lower in 2005 compared to 2004 which reflects a cost containment effort on the part of the Company.

The following table identifies the changes in research and development expense for the three and six months ended July 31, 2005 compared to similar periods in the prior year.

Research and development expenses	For the three months ended July 31			For the six months ended July 31		
	2005	2004	Increase (decrease)	2005	2004	Increase (decrease)
	\$	\$	\$	\$	\$	\$
Sub-contract and consulting	74,568	172,312	(97,744)	154,349	477,023	(322,674)

Salaries, wages and benefits	84,337	109,290	(24,953)	240,595	231,460	9,135
Legal (patent prosecution)	22,203	44,699	(22,496)	40,828	110,408	(69,580)
Rent	46,802	21,106	25,696	99,773	64,143	35,630
Other R&D costs	64,144	27,128	37,016	92,501	68,071	24,430
Supplies	27,413	19,277	8,136	67,164	57,995	9,169
Total research and development expenses	319,467	393,812	(74,345)	695,210	1,009,100	(313,890)

Salaries, wages and benefits and sub-contract and consulting decreased during the period ended July 31, 2005 due to government funding received during the period which was offset against these expenditures. In addition, the decrease in R&D expenditures reflects a focus of resources on the Company's core R&D technologies.

Rent has increased in 2005 compared to 2004 due to a change in the allocation of rental costs to reflect that the Company's facility space is devoted to R&D activities.

Discontinued Operations

On July 30, 2004 the Company sold its assets relating to the contract manufacturing operations in Edmonton, Alberta. The following table identifies the activity in connection with the Company's discontinued operations for the three and six month periods ended July 31, 2005 compared to the three and six month periods ended July 31, 2004.

Discontinued operations	For the three months ended July 31			For the six months ended July 31		
	2005	2004	Increase (decrease)	2005	2004	Increase (decrease)
	\$	\$	\$	\$	\$	\$
Revenue	nil	36,955	(36,955)	nil	216,903	(216,903)
Direct Costs	nil	24,052	(24,052)	nil	133,129	(133,129)
General and administrative expenses	nil	32,623	(32,623)	nil	74,964	(74,964)
Gain on disposal of assets	nil	400,207	(400,207)	nil	400,207	(400,207)
Income / (loss)	nil	380,487	(380,487)	nil	409,017	(409,017)

Stock-Based Compensation Expense

During the three and six month periods ended July 31, 2005, the Company granted a total of 410,000 and 1,210,000 stock options, respectively. 800,000 of these options were granted to an employee in Q1 with an exercise price of \$0.31. 410,000 of these options were granted in Q2 to directors, an employee and consultants at an exercise price of \$0.25. For the three and six month periods ended July 31, 2004, the Company granted a total of 500,000 and 750,000 stock options, respectively. 250,000 of these options were granted in Q1 to consultants with exercise prices ranging from \$0.52 to \$0.64. 500,000 of these options were granted in Q2 to a consultant with an exercise price of \$1.00. For the three and six month periods ended July 31, 2005, the fair value of the vested options, \$45,333 and \$94,218, respectively, were recognized as an expense and credited to contributed surplus (for the three and six month periods ended July 31, 2004 – \$96,500 and \$166,500, respectively).

Chinese Operations

In February, 2005, the Company's Board made a decision to discontinue operations in China.

The Company has almost completed the early termination and cancellation of Shanghai Altachem Pharma Biotechnology Ltd. ("SACP") and repatriation of SACP's assets back to Canada. This process is expected to be completed by the end of the 3rd quarter of calendar 2005.

The Company is continuing its efforts to sell the SHGP manufacturing facility. Several parties have expressed an interest in the facility and are completing their due diligence.

The financial aspects of Altachem's Chinese operations must be converted into Canadian dollars to prepare annual and quarterly financial statements. At July 31, 2005 SACP and SHGP are treated as integrated operations and as a result, any foreign exchange gain or loss is included in income. For the three and six month periods ended July 31, 2005, foreign exchange gains of \$546 and 42,327, respectively, compared to a foreign exchange loss of (\$482,471) and a gain of \$75,252, respectively, for the three and six month periods ended July 31, 2004 have been recorded on the statement of operations and deficit. The foreign exchange gains/(losses) for the periods relate to the Company's investment in China and are due to (i) fluctuations in the value of the US dollar and Chinese yuan relative to the Canadian dollar, and, (ii) a decrease in the amount of the Company's investment in China.

Liquidity and Capital Resources

At July 31, 2005, cash and cash equivalents was \$1,863,553 as compared to \$1,931,293 at January 31, 2005.

The majority of the Company's cash balance at year end was held by its Chinese subsidiary, SACP. During the six month period ended July 31, 2005, the Company received initial approval from the Chinese Authorities to collapse SACP and return its cash and technology assets to Canada. Final approval and completion of this process is expected to occur by the end of Q3, calendar 2005.

During the six month period ended July 31, 2005, the Company obtained \$75,000 of additional bridge financing in the form of an interest bearing loan from a director (see "Related Party Transactions" for further details). Also during the period, the Company repaid a portion of its bridge financing loans such that, at July 31, 2005, \$225,000 of interest bearing notes were outstanding. The Company intends to repay this obligation during Q3 of fiscal 2006.

On March 23, 2005, the Company issued a \$1,000,000 principal amount 8% secured convertible debenture with a one year maturity to two arm's length parties. The debenture is collateralized by funds held in SACP. The debenture is repayable in blended monthly installments of \$6,667 with the balance, including accrued interest, due on March 22, 2006. The debenture may be converted into common shares of the Company at a price of \$0.45 per common share and may be redeemed at any time by the Company.

On March 7 and May 17, 2005, the Company completed the first and second tranche of a non-brokered private placement with the sale of 5,972,000 units for gross proceeds of \$1,493,000 (net proceeds of approximately \$1,432,000). Each unit is comprised of one common share and one-

half share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$0.45 at any time within one year of issuance. The proceeds from these private placements are being used for general corporate purposes and for working capital.

During the six month period ended July 31, 2005, the Company recognized approximately \$120,000 of federal government assistance in the form of a National Research Council Industrial Research Assistance Program (“IRAP”) grant to cover salaries and contractor fees related to the development of the Company’s photodynamic therapy for prostate cancer, based on the Company’s lead proprietary hypocrellin derivative. This funding is part of a \$295,000 grant the Company is eligible to receive for the period to March 31, 2006.

Also during the period, the Company was awarded a grant from Alberta Ingenuity Fund to cover salary expenditures related to the development of the Company’s photodynamic therapy for prostate cancer. The \$110,000 grant is being received over a 24 month period commencing in May, 2005.

During the three months ended July 31, 2005, the Company received approximately \$40,000 in funding from Revenue Quebec related to scientific research and experimental development claims made for expenditures incurred in Danamedix Inc. in fiscal 2002 and 2003.

Based on current operating budgets and assuming repatriation and liquidation of assets from Altachem’s Chinese subsidiaries, management believes that the capital resources of the Company should be sufficient to fund operations into the first quarter of calendar 2006.

Altachem’s funding needs will vary as its drug development products move into and through clinical trials. The Company will seek additional capital through the sale of non-core assets, further equity financings, licensing arrangements and strategic partnerships.

Related Party Transactions

During the year ended January 31, 2005, the Company obtained bridge financing in the amount of \$650,000 from companies controlled by two former directors, Mr. Wayne Minion and Mr. Andrew Boddy. During the six month period ended July 31, 2005, the Company paid this obligation in full.

During the year ended January 31, 2005, the Company obtained additional bridge financing totaling \$134,000 from a former director, Mr. Robert Sydenham and from a company controlled by Mr. Sydenham. During the six month period ended July 31, 2005, the Company paid this obligation in full.

On February 8, 2005, the Company obtained additional bridge financing in the amount of \$75,000 from Dr. Ragupathy (“Madi”) Madiyalakan. At that time, the Company converted all of Dr. Madiyalakan’s loans and \$20,000 of legal expenses incurred by Dr. Madiyalakan on behalf of the Company to interest bearing notes (totaling \$225,000) at 6% per annum. At July 31, 2005, all of this debt was outstanding.

Subsequent Events

On August 8, 2005, the Company entered into an agreement with a company controlled by Dr. Madiyalakan to provide consulting services. The consulting agreement requires the Company to make monthly payments of \$7,500 and is for a term of 12 months.

Risks and Uncertainties

Altachem's proprietary technologies are in various stages of development and some technologies have not received regulatory approval to begin clinical trials. It will be necessary for the Company to produce sufficient preclinical data in order to receive regulatory approval to begin clinical trials. There is no assurance that regulatory approval will be received to begin clinical trials. For the proprietary technologies that have received regulatory approval to begin clinical trials, future success will depend upon the ability of the Company to move the products through clinical trials, the effect and safety of these products, the timing and cost to receive regulatory and marketing approvals and the filing and maintenance of patent claims.

Altachem's proprietary technologies have exposure to risks associated with commercialization. Even after product approval is obtained, there is no assurance that the Company will have a sufficient market for its products or the working capital required for commercialization.

Given their short-term maturity, the fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and demand notes approximate the carrying value.

The fair value of the obligation under capital lease, calculated at the present value of future contractual payments of principal and interest and discounted at the current market rate of interest available to the Company for debt instruments with similar terms and maturity, approximates the carrying value.

A substantial portion of the Company's cash reserves are denominated in US dollars and Chinese yuan. In addition, the Company has a US dollar denominated capital lease obligation. These result in financial risk due to fluctuations in the value of the Canadian dollar relative to the US dollar and the Chinese yuan. The Company does not use derivative financial instruments to reduce its foreign exchange exposure.

The Company maintains clinical trial liability and product liability insurance; however, it is possible that this coverage may not provide full protection against all risks.

The Company may be exposed to risks associated with malfunctioning equipment, catastrophic events and other events within and outside of the Company's control. The Company maintains insurance believed to be adequate to cover any eventuality, but there is no guarantee that coverage will be sufficient for all purposes.

To a large degree, the Company's success is dependant upon attracting and retaining key management and scientific personnel to further the Company's drug development programs.

There is a risk that required personnel may not be available to the Company when needed and, as a result, this may have a negative impact on the Company.

Altachem must continue to raise additional capital through the exercise of stock options and warrants, issuing new share capital through equity financing, licensing arrangements and/or strategic partnerships. The Company's ability to raise additional capital will depend upon the progress of moving its drug development products into and through clinical trials and the strength of the equity markets, which are uncertain. There can be no assurance that additional capital will be available. As described above in the Liquidity and Capital Resources section, the majority of the Company's cash balance is held in its Chinese subsidiary. The accessibility and the effective use of these funds in the short and long-term will determine the Company's need to raise additional capital.