

Interim Consolidated Financial Statements  
(*Unaudited*)

## **Æterna Zentaris Inc.**

As at and for the three-month and six-month periods ended June 30, 2009 and 2008  
(expressed in thousands of US dollars)

# **Æterna Zentaris Inc.**

## **Interim Consolidated Financial Statements** *(Unaudited)*

As at and for the three-month and six-month periods ended June 30, 2009 and 2008

### **Financial Statements**

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# Æterna Zentaris Inc.

## Interim Consolidated Balance Sheets

(expressed in thousands of US dollars)

(Unaudited)

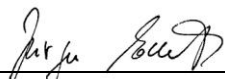
	As at June 30, 2009	As at December 31, 2008
	\$	\$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	56,817	49,226
Short-term investments	518	493
Accounts receivable		
Trade	3,940	3,425
Other	364	1,100
Income taxes	96	48
Inventory (note 5)	3,587	3,385
Prepaid expenses and other current assets	5,433	4,047
	<u>70,755</u>	<u>61,724</u>
<b>Property, plant and equipment</b>	6,387	6,682
<b>Deferred charges and other long-term assets</b>	7,327	5,959
<b>Intangible assets</b>	22,911	23,894
<b>Goodwill (note 4)</b>	10,060	10,083
	<u>117,440</u>	<u>108,342</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	14,365	13,690
Income taxes	801	800
Deferred revenues	11,840	7,631
Current portion of long-term payable	52	49
	<u>27,058</u>	<u>22,170</u>
<b>Deferred revenues</b>	76,734	54,433
<b>Long-term payable</b>	155	172
<b>Employee future benefits (note 7)</b>	10,124	10,092
	<u>114,071</u>	<u>86,867</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital (note 8)</b>	37,431	30,566
<b>Warrants (note 8)</b>	1,608	-
<b>Other capital</b>	79,793	79,669
<b>Deficit</b>	(128,282)	(102,814)
<b>Accumulated other comprehensive income</b>	12,819	14,054
	<u>3,369</u>	<u>21,475</u>
	<u>117,440</u>	<u>108,342</u>

Basis of presentation (note 1)

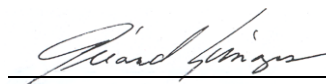
Evaluation of going concern (note 1)

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

Approved by the Board of Directors



Juergen Ernst  
Director



Gérard Limoges  
Director

# Æterna Zentaris Inc.

Interim Consolidated Statements of Changes in Shareholders' Equity  
 For the three-month and six-month periods ended June 30, 2009 and 2008  
 (expressed in thousands of US dollars)

<i>(Unaudited)</i>	Common shares (number of)	Share capital	Warrants	Other capital	Deficit	Accumulated other comprehensive income	Total
		\$		\$	\$	\$	\$
<b>Balance – December 31, 2008</b>	<b>53,187,470</b>	<b>30,566</b>	-	<b>79,669</b>	<b>(102,814)</b>	<b>14,054</b>	<b>21,475</b>
Net loss for the period	-	-	-	-	(25,468)	-	(25,468)
Issuance pursuant to registered direct offering, net of transaction costs (note 8)	5,319,149	6,865	1,608	-	-	-	8,473
Foreign currency translation adjustment	-	-	-	-	-	(1,235)	(1,235)
Stock based compensation costs	-	-	-	124	-	-	124
<b>Balance – June 30, 2009</b>	<b>58,506,619</b>	<b>37,431</b>	<b>1,608</b>	<b>79,793</b>	<b>(128,282)</b>	<b>12,819</b>	<b>3,369</b>

<i>(Unaudited)</i>	Common shares (number of)	Share capital	Other capital	Deficit	Accumulated other comprehensive income	Total
		\$	\$	\$	\$	\$
<b>Balance – December 31, 2007</b>	<b>53,187,470</b>	<b>30,566</b>	<b>79,306</b>	<b>(42,997)</b>	<b>21,716</b>	<b>88,591</b>
Net loss for the period	-	-	-	(31,445)	-	(31,445)
Foreign currency translation adjustment	-	-	-	-	519	519
Variation in fair value of short-term investments, net of income taxes	-	-	-	-	12	12
Stock based compensation costs	-	-	142	-	-	142
<b>Balance – June 30, 2008</b>	<b>53,187,470</b>	<b>30,566</b>	<b>79,448</b>	<b>(74,442)</b>	<b>22,247</b>	<b>57,819</b>

	As at June 30,	
	2009	2008
<b>Accumulated Other Comprehensive Income</b>	<b>\$</b>	<b>\$</b>
Consisting of the following:		
Foreign currency translation adjustments	<b>12,816</b>	22,225
Variation in fair market value of short-term investments, net of income taxes	<b>3</b>	22
Accumulated Other Comprehensive income	<b>12,819</b>	22,247
<b>Deficit</b>	<b>(128,282)</b>	(74,442)
Total Accumulated Other Comprehensive Income and Deficit	<b>(115,463)</b>	(52,195)

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

## Æterna Zentaris Inc.

### Interim Consolidated Statements of Loss and Comprehensive Loss

For the three-month and six-month periods ended June 30, 2009 and 2008

(expressed in thousands of US dollars, except share and per share data)

<i>(Unaudited)</i>	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Revenues</b>				
Sales and royalties	<b>5,427</b>	8,250	<b>10,398</b>	16,192
License fees and other	<b>2,952</b>	2,207	<b>4,092</b>	4,013
	<b>8,379</b>	10,457	<b>14,490</b>	20,205
<b>Operating expenses</b>				
Cost of sales	<b>4,545</b>	4,758	<b>8,239</b>	9,362
Research and development costs, net of tax credits and grants	<b>12,076</b>	17,345	<b>23,513</b>	31,034
Selling, general and administrative	<b>3,102</b>	6,606	<b>6,656</b>	11,010
Depreciation and amortization				
Property, plant and equipment	<b>331</b>	397	<b>642</b>	766
Intangible assets	<b>563</b>	876	<b>1,120</b>	1,716
	<b>20,617</b>	29,982	<b>40,170</b>	53,888
<b>Loss from operations</b>	<b>(12,238)</b>	(19,525)	<b>(25,680)</b>	(33,683)
<b>Other income (expenses)</b>				
Interest income	<b>118</b>	311	<b>274</b>	588
Interest expense	-	(53)	<b>(2)</b>	(68)
Foreign exchange (loss) gain	<b>(960)</b>	(502)	<b>(60)</b>	1,753
Loss on disposal of long-lived assets held for sale	-	(810)	-	(35)
	<b>(842)</b>	(1,054)	<b>212</b>	2,238
<b>Net loss for the period</b>	<b>(13,080)</b>	(20,579)	<b>(25,468)</b>	(31,445)
<b>Net loss per share</b>				
Basic and diluted	<b>(0.24)</b>	(0.39)	<b>(0.48)</b>	(0.59)
<b>Weighted average number of shares</b> (note 11)				
Basic and diluted	<b>53,655,087</b>	53,187,470	<b>53,422,571</b>	53,187,470
<b>Consolidated Statements of Comprehensive Loss</b>				
<i>(Unaudited)</i>				
<b>Net loss for the period</b>	<b>(13,080)</b>	(20,579)	<b>(25,468)</b>	(31,445)
Other comprehensive income (loss):				
Foreign currency translation adjustments	<b>62</b>	528	<b>(1,235)</b>	519
Variation in the fair value of short-term investments, net of income taxes	-	(35)	-	12
<b>Comprehensive loss</b>	<b>(13,018)</b>	(20,086)	<b>(26,703)</b>	(30,914)

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

# Æterna Zentaris Inc.

## Interim Consolidated Statements of Cash Flows

For the three-month and six-month periods ended June 30, 2009 and 2008

(expressed in thousands of US dollars)

<i>(Unaudited)</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Cash flows from operating activities</b>				
Net loss for the period	(13,080)	(20,579)	(25,468)	(31,445)
Items not affecting cash and cash equivalents				
Depreciation and amortization	894	1,273	1,762	2,482
Stock based compensation costs	64	(128)	124	142
Loss on disposal of long-lived assets held for sale	-	810	-	35
Employee future benefits	166	215	18	400
Amortization of deferred charges and other long-term assets	290	32	1,554	127
Amortization of deferred revenues	(2,666)	(1,410)	(4,728)	(2,795)
Accretion on long-term borrowings	-	(15)	-	-
Foreign exchange loss (gain) on items denominated in foreign currencies	950	346	50	(903)
Amortization of prepaid expenses and other non-cash items	4,725	2,589	9,105	5,554
Changes in operating assets and liabilities (note 6)	(7,477)	(2,512)	16,719	(1,218)
Net cash used in operating activities	(16,134)	(19,379)	(864)	(27,621)
<b>Cash flows from financing activities</b>				
Proceeds from issuance of common shares and warrants, net of cash transaction costs of \$808 (note 8)	9,192	-	9,192	-
Repayment of long-term debt and payable	-	(362)	(24)	(362)
Deferred share issue expenses	-	12	-	(438)
Net cash provided by (used in) financing activities	9,192	(350)	9,168	(800)
<b>Cash flows from investing activities</b>				
Proceeds from sale and maturity of short-term investments	-	8,839	-	17,213
Net proceeds from sale of long-lived assets held for sale	-	6,545	-	14,854
Purchases of property, plant and equipment	(9)	(1,005)	(69)	(1,061)
Disposal of property, plant and equipment	4	10	4	12
Purchases of amortizable intangible assets	(280)	(1)	(280)	(16)
Net cash provided by (used in) investing activities	(285)	14,388	(345)	31,002
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>2,050</b>	<b>(82)</b>	<b>(368)</b>	<b>(1,418)</b>
<b>Net change in cash and cash equivalents</b>	<b>(5,177)</b>	<b>(5,423)</b>	<b>7,591</b>	<b>1,163</b>
<b>Cash and cash equivalents – Beginning of period</b>	<b>61,994</b>	<b>16,858</b>	<b>49,226</b>	<b>10,272</b>
<b>Cash and cash equivalents – End of period</b>	<b>56,817</b>	<b>11,435</b>	<b>56,817</b>	<b>11,435</b>
Cash and cash equivalents components:				
Cash	29,027	11,435	29,027	11,435
Cash equivalents	27,790	-	27,790	-
	<b>56,817</b>	<b>11,435</b>	<b>56,817</b>	<b>11,435</b>

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

## **Æterna Zentaris Inc.**

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

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(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

### **1 Basis of presentation, use of estimates and evaluation of going concern**

The accompanying interim consolidated financial statements of Æterna Zentaris Inc. (“the Company”) as at June 30, 2009 and for the three-month and six-month periods ended June 30, 2009 and 2008 are unaudited. They have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) for interim financial information, which differ in certain respects from those prepared in accordance with United States generally accepted accounting principles (“US GAAP”). The recognition, measurement and disclosure differences as they relate to the Company are described in note 12. The unaudited consolidated financial statements reflect all adjustments which, in the opinion of the Company’s management, are necessary for a fair statement of the results of operations, financial position and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature.

The accompanying interim consolidated financial statements comply with generally accepted accounting principles applicable to interim financial statements and have been prepared on a basis consistent with the Company’s annual consolidated financial statements as at and for the year ended December 31, 2008, except for the adoption of the new accounting standards described in note 2.

These interim consolidated financial statements do not include all of the disclosures applicable to annual consolidated financial statements. A full description of the Company’s accounting policies can be found in the Company’s consolidated financial statements as at and for the year ended December 31, 2008. While management believes that the disclosures presented are adequate and highlight all material changes during the quarter, these interim consolidated financial statements should be read in conjunction with the most recent annual consolidated financial statements.

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Those estimates and assumptions also affect the disclosure of contingencies at the date of the financial statements as well as the reported amounts of revenues and expenses during the reported periods. Significant estimates are generally made in connection with the calculation of revenues, research and development expenses, stock based compensation costs, as well as in determining the allowance for doubtful accounts, inventory and provisions for obsolete inventory, future income tax assets and liabilities, the useful lives of property, plant and equipment and intangible assets with finite lives, the valuation of intangible assets and goodwill, the fair value of stock options and warrants granted, employee future benefits and certain other accrued liabilities. The Company bases its estimates on historical experience, where relevant, and on various other assumptions that management believes to be reasonable under the circumstances. Actual results could differ from those estimates.

## **Æterna Zentaris Inc.**

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

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(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

### *Evaluation of going concern, results of operations, and management's plans:*

Management is required to make an assessment of the Company's ability to continue as a going concern and takes into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet date. Disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern. Management's assessment took into account previously disclosed transactions, the completion of the registered direct offering discussed in note 8, and the Company's strategic plan and corresponding budgets for 2009 and forecasts for 2010 and 2011. As a result of this assessment, management believes that the Company has sufficient financial resources to fund planned expenditures and other working capital needs for at least the 12-month period following the balance sheet date.

## **2 New accounting standards and pronouncements**

### **a) Adopted in 2009**

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 3064, *Goodwill and Intangible Assets*. This standard provides guidance on the recognition of intangible assets and the criteria for asset recognition, clarifying the applications of the concept of matching revenues and expenses, whether these assets are separately acquired or are developed internally. The standard applies to the Company's interim and annual financial statements for periods beginning on January 1, 2009. Adoption of this standard has not had any impact on the Company's consolidated financial statements.

In January 2009, the CICA issued Handbook Section 1582, *Business Combinations*, which replaces the existing standards. This section establishes the standards for the accounting of business combinations and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. The Company has early adopted this standard effective January 1, 2009 and will apply the provisions thereof prospectively to future business combinations.

In January 2009, the CICA issued Handbook Section 1601, *Consolidated Financial Statements*, which replaces the existing standards and establishes the standards for preparing consolidated financial statements and is effective for 2011. The Company has early adopted this standard effective January 1, 2009 and will apply the provisions thereof prospectively, where applicable.

In January 2009, the CICA issued Handbook Section 1602, *Non-controlling Interests*, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. The Company has early adopted this standard effective January 1, 2009 and will apply the provisions thereof prospectively to future business combinations, where applicable.

In January 2009, the CICA's Emerging Issue Committee ("EIC") issued Abstract EIC-173, "Credit Risk and the Fair Value of Financial Assets and Liabilities", which requires entities to take both counterparty credit risk and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives. The Company adopted EIC-173 on January 1, 2009, and such adoption did not have a material impact on the Company's consolidated financial statements.

## **Æterna Zentaris Inc.**

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

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(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

### **b) Not yet adopted**

In June 2009, the CICA amended Handbook Section 3862, *Financial Instruments—Disclosures*, to include additional disclosure requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure requirements for publicly accountable enterprises. The amendments apply to annual financial statements for years ending after September 30, 2009. The Company does not expect that adoption of these amendments will have a significant impact on the consolidated financial statements.

In July 2009, the CICA amended Handbook Section 1506, *Accounting Changes*, to exclude from its scope changes in accounting policies upon the complete replacement of an entity's primary basis of accounting. The amendments apply to interim and annual financial statements relating to years beginning on or after July 1, 2009. The Company does not expect that adoption of these amendments will have a significant impact on the consolidated financial statements.

### **3 Development, commercialization and license agreement**

On March 4, 2009, the Company entered into a development, commercialization and license agreement (the "Agreement") with sanofi-aventis ("sanofi"). The Agreement is for the development, registration and marketing of cetorelix in benign prostatic hyperplasia ("BPH") for the United States market. Under the terms of the Agreement, sanofi made an upfront nonrefundable license fee payment to the Company of \$30,000,000. Also per the Agreement, the Company will be entitled to receive a total of \$135,000,000 in payments upon achieving certain pre-established regulatory and commercial milestones. Furthermore, the Company will be entitled to receive escalating double-digit royalties on future net sales of cetorelix for BPH in the United States, while retaining the option to co-promote the product, currently under development, in that territory. As with similar prior arrangements, the Company has applied the provisions of the EIC's Abstract No. 142, "Revenue Arrangements with Multiple Deliverables", and has determined that all deliverables and performance obligations contemplated by the Agreement should be accounted for as a single unit of accounting, limited to amounts that are not contingent upon the delivery of additional items or the meeting of other specified performance conditions which are not currently known, probable or estimable.

The Company has deferred the nonrefundable license fee and is amortizing the related payment as revenue on a straight-line basis over the estimated life cycle of the product that is currently under development. The estimated product life cycle approximates the duration of the Company's continuing involvement and performance obligations under the Agreement as well as the expected period over which sanofi will derive value from the use of, and access to, the license.

In determining the period over which license revenues are to be recognized, the Company has considered the remaining life of pertinent applicable patents as the most reasonable basis for estimating the underlying product's life cycle. However, the Company may adjust the amortization period based on appropriate facts and circumstances not yet known, including, but not limited to, the extension(s) of patents, the granting of new patents, the economic lives of competing products and other events that would significantly change the duration of the Company's continuing involvement and performance obligations and pertinent benefits expected to be derived by sanofi.

## Æterna Zentaris Inc.

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

Future regulatory and commercial milestones will be recognized as revenue individually and in full upon the actual achievement of the related milestone given the substantive nature of each milestone. Lastly, upon initial commercialization and sale of the developed product, the Company will recognize royalty revenues as earned, based on the contractual percentages applied to the actual net sales achieved by sanofi, as per the Agreement.

As a result of entering into the Agreement with sanofi, the Company is obliged to pay a royalty to the Tulane Educational Fund (“Tulane”) pursuant to a license agreement whereby the Company obtained licenses to use Tulane’s patents to develop, manufacture, market and distribute various substances, including cetorelix. This royalty, amounting to \$3,000,000, was deferred, is not yet paid and is being amortized to selling expenses over the same period and under the same method as the revenue recognition period of the license fee revenues.

During the three-month and six-month periods ended June 30, 2009, the Company recognized a total of approximately \$898,000 and \$1,184,000, respectively, in license fee revenues in connection with the Agreement with sanofi. Concurrently, during the same periods, the Company incurred approximately \$90,000 and \$118,000, respectively, in expenses, which are represented by the royalty payable to Tulane, discussed above.

### 4 Goodwill

The change in carrying value is as follows:

	\$
<b>Balance as at December 31, 2008</b>	<b>10,083</b>
Impact of foreign exchange rate changes	(23)
	<hr/>
<b>Balance as at June 30, 2009</b>	<b>10,060</b>

### 5 Inventory

	As at June 30, 2009	As at December 31, 2008
	<hr/>	<hr/>
	\$	\$
Raw materials	2,251	2,367
Work in progress	1,223	682
Finished goods	113	336
	<hr/>	<hr/>
	<b>3,587</b>	3,385
	<hr/>	<hr/>

## Æterna Zentaris Inc.

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

### 6 Supplemental disclosure of cash flow information

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Changes in operating assets and liabilities</b>				
Accounts receivable	(1,680)	(1,024)	152	(499)
Inventory	270	527	(170)	900
Prepaid expenses and other current assets	(5,198)	(1,832)	(10,893)	(4,754)
Deferred charges and other long-term assets	-	-	(3,000)	-
Accounts payable and accrued liabilities	(869)	(111)	659	3,216
Deferred revenues	-	-	30,000	-
Income taxes	-	(72)	(29)	(81)
	<b>(7,477)</b>	<b>(2,512)</b>	<b>16,719</b>	<b>(1,218)</b>

### 7 Employee future benefits

The Company's subsidiary in Germany provides unfunded defined benefit pension plans and unfunded postemployment benefit plans for some groups of employees. Provisions for pension obligations are established for benefits payable in the form of retirement, disability and surviving dependent pensions.

For the three-month and six-month periods ended June 30, 2009, total defined benefit pension expenses amounted to approximately \$196,500 and \$379,500, respectively (\$235,000 and \$435,000, respectively, for the same periods in 2008). For the three-month and six-month periods ended June 30, 2009, total expenses related to other defined benefit plans amounted to approximately \$99,200 and \$177,200, respectively (\$138,000 and \$215,000, respectively, for the same periods in 2008).

The Company sponsors a matching defined contribution plan at its Canadian headquarters. Under that plan, the Company may contribute amounts equal to a percentage of employee contributions. For the three-month and six-month periods ended June 30, 2009, matching contributions to the plan totalled approximately \$nil and \$41,000, respectively (\$6,000 and \$35,500, respectively, for the same periods in 2008).

The Company also sponsors a 401K plan in its US subsidiary. Under this plan, the Company may contribute a discretionary amount equal to a percentage of employee contributions to the plan and may also make discretionary profit sharing contributions. During the three-month and six-month periods ended June 30, 2009, matching contributions to the plan amounted to approximately \$14,000 and \$29,000, respectively (\$23,000 and \$46,000, respectively, for the same periods in 2008).

### 8 Registered direct offering

On June 23, 2009, the Company completed a registered direct offering ("the Offering") of 5,319,149 units, with each unit consisting of one common share and a warrant to purchase 0.35 common shares at a price of \$1.88 per unit. The related warrants (the "Investor warrants") represent the right to acquire an aggregate

## **Æterna Zentaris Inc.**

Notes to Interim Consolidated Financial Statements (unaudited)

For the three-month and six-month periods ended June 30, 2009 and 2008

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(tabular amounts in thousands of US dollars, except share/option data and as otherwise noted)

of 1,861,702 common shares, as discussed below. The Company also granted warrants to the sole placement agent engaged in connection with the Offering (the "Compensation warrants"), as discussed below.

Total proceeds raised through the Offering amounted to \$10,000,000, less cash and non-cash transaction costs of approximately \$1,528,000. The purchasers in the offering were comprised of institutional investors, and the securities described above were offered by the Company pursuant to a shelf prospectus dated September 27, 2007 and a prospectus supplement filed on June 18, 2009.

### *Investor warrants*

The Company granted a total of 5,319,149 warrants to the institutional investors who participated in the Offering. Each Investor warrant entitles the holder to purchase 0.35 of a common share at an exercise price of \$2.06 per share. The Investor warrants are exercisable between September 23, 2009 and December 23, 2011, and, upon complete exercise, would result in the issuance of an aggregate of 1,861,702 common shares of the Company.

The Company estimated the fair value attributable to the Investor warrants of \$1,620,998 as of the date of grant by applying the Black-Scholes pricing model, to which the following additional assumptions were applied: a risk-free annual interest rate of 1.74%, expected volatility of 90.6%, an expected term of 2.5 years, dividend yield of 0.0% and an issue-date market share price of \$1.75. Transaction costs allocated to the Investor warrants amounted to approximately \$247,000.

The Investor warrants may be exercised, at the option of the holder, by cash payment of the exercise price or, upon the existence of certain conditions, by "cashless exercise", which means that in lieu of paying the aggregate exercise price for the shares being purchased upon exercise of the warrants in cash, the holder will receive a certificate for the number of shares underlying the warrants equal to the quotient obtained by applying a formula, as defined by the terms of each Investor warrant. The Company will not receive additional proceeds to the extent that warrants are exercised by cashless exercise.

The exercise price and number of shares of common stock issuable on exercise of the Investor warrants may be adjusted in certain circumstances, including stock dividends or splits, subsequent rights offerings, pro-rata distributions and pursuant to transactions involving the merger or consolidation of the Company with another entity or other Fundamental Transaction, as defined in the warrant.

Additionally, and notwithstanding anything to the contrary, in the event of any type of Fundamental Transaction, as defined in the warrant, the Company or any successor entity shall have, at the Company's option, the opportunity to exercise the Investor warrants, or shall, at the holder's option, purchase the Investor warrants from the holders by paying to the holders an amount of cash equivalent to the Black-Scholes value, as defined, of the remaining unexercised portion of the Investor warrant on the date of the consummation of an aforementioned Fundamental Transaction.

### *Compensation warrants*

The Company granted a total of 820,668 warrants to the sole placement agent engaged in connection with the Offering. Each Compensation warrant entitles the holder to purchase 0.35 of a common share at an exercise price of \$2.35 per share. The Compensation warrants are exercisable between December 23, 2009 and December 23, 2011, and, upon complete exercise, would result in the issuance of 287,234 common shares of the Company.

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The Company estimated the fair value attributable to the Compensation warrants of \$234,251 as of the date of grant by applying the Black-Scholes pricing model, to which the following additional assumptions were applied: a risk-free annual interest rate of 1.74%, expected volatility of 90.6%, an expected term of 2.5 years, an expected dividend yield of 0.0% and an issue-date market share price of \$1.75. The initial fair value of the Compensation warrants has been accounted for as additional transaction costs, since the instruments were granted to the sole placement agent as part of the terms of the underlying engagement and in recognition of the efforts made in connection with the Offering.

The terms of the Compensation warrants, with the exception of the exercise price and period of exercise, are substantially the same as those contained in the Investor warrants discussed above.

### 9 Stock option plan

The following tables summarize the activity under the Company's stock option plan.

#### *Canadian Dollar Options:*

	Six months ended June 30, 2009		Year ended December 31, 2008	
	Number	Weighted average exercise price (CAN\$)	Number	Weighted average exercise price (CAN\$)
Balance - Beginning of period	4,490,759	3.28	4,136,092	3.83
Granted	-	-	735,000	0.59
Forfeited	(15,000)	0.55	(165,000)	3.41
Expired	(3,593)	1.73	(215,333)	4.51
Balance - End of period	4,472,166	3.29	4,490,759	3.28

#### *US Dollar Options:*

	Six months ended June 30, 2009		Year ended December 31, 2008	
	Number	Weighted average exercise price (US\$)	Number	Weighted average exercise price (US\$)
Balance - Beginning of period	313,334	2.76	870,000	2.79
Forfeited	(20,000)	1.78	(556,666)	2.80
Balance - End of period	293,334	2.83	313,334	2.76

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### 10 Financial instruments and financial risk management

#### Fair value

Cash and cash equivalents, short-term investments, accounts receivable and accounts payable and accrued liabilities are financial instruments whose fair value approximates their carrying value due to their short-term maturity.

#### Financial risk management

Effective January 1, 2009, due to a change in economic facts and circumstances, the Company's parent entity and US subsidiary adopted the Euro as their functional currency. This change, accounted for prospectively, did not result in any significant impact upon the interim consolidated financial statements.

Since the Company operates on an international scale, it is exposed to currency risks as a result of potential exchange rate fluctuations related to non-intragroup transactions. Fluctuations in the US dollar ("US\$") and the Canadian dollar vis-à-vis the Euro ("EUR") exchange rates could have a potentially significant impact on the Company's results of operations. The following variations are reasonably possible over a 12-month period:

- Foreign exchange rate variation of -5% (depreciation of the EUR) and +5% (appreciation of the EUR) against the US\$, from a period-end rate of EUR1 = US\$1.4013.

If these variations were to occur, the impact on the Company's consolidated net loss for each category of financial instruments held at June 30, 2009 would be as follows:

	Carrying amount	Balances denominated in US\$	
		-5%	+5%
	\$	\$	\$
Cash and cash equivalents	36,097	1,805	(1,805)
<b>Total impact on consolidated net loss - (increase)/decrease</b>		<b>1,805</b>	<b>(1,805)</b>

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### 11 Net loss per share

The following table sets forth the computation of basic and diluted net loss per share.

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Net loss</b>	<b>(13,080)</b>	<b>(20,579)</b>	<b>(25,468)</b>	<b>(31,445)</b>
<b>Basic weighted average number of shares outstanding</b>	<b>53,655,087</b>	53,187,470	<b>53,422,571</b>	53,187,470
Dilutive effect of stock options	<b>383,252</b>	-	<b>255,015</b>	-
<b>Diluted weighted average number of shares outstanding</b>	<b>54,038,339</b>	53,187,470	<b>53,677,586</b>	53,187,470
<b>Items excluded from the calculation of diluted net loss per share because the exercise price was greater than the average market price of the common shares</b>				
Stock options	<b>4,045,500</b>	4,196,093	<b>4,045,500</b>	4,196,093
Warrants (number of equivalent shares)	<b>2,148,936</b>	-	<b>2,148,936</b>	-

For the three-month and six-month periods ended June 30, 2009 and 2008, the diluted net loss per share was the same as the basic net loss per share since the effect of the assumed exercise of stock options and warrants to purchase common shares (2009 only) is anti-dilutive. Accordingly, the diluted net loss per share for these periods was calculated using the basic weighted average number of shares outstanding.

### 12 Differences between Canadian and US GAAP

The accompanying interim consolidated financial statements have been prepared in accordance with Canadian GAAP. Significant measurement and disclosure differences as compared to US GAAP are set out in note 27 to the Company's most recent annual consolidated financial statements. This note describes significant changes occurring since the most recent annual consolidated financial statements and provides a quantitative analysis of all significant differences. All disclosures required in annual financial statements under US GAAP and as per Regulation S-X of the Securities and Exchange Commission ("SEC") in the United States have not been provided in these interim consolidated financial statements.

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### Reconciliation of net loss to US GAAP

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Net loss for the period under Canadian GAAP</b>	<b>(13,080)</b>	(20,579)	<b>(25,468)</b>	(31,445)
Variation in warrant liability	(a) 33	-	33	-
Amortization of in-process R&D	(b) 259	382	517	736
Net loss for the period under US GAAP	<b>(12,788)</b>	(20,197)	<b>(24,918)</b>	(30,709)
<b>Net loss per share</b>				
Basic and diluted	<b>(0.24)</b>	(0.38)	<b>(0.47)</b>	(0.58)
<b>Weighted average number of shares outstanding under US GAAP</b> (note 11)				
Basic and diluted	<b>53,655,087</b>	53,187,470	<b>53,422,571</b>	53,187,470

### Reconciliation of shareholders' equity to conform to US GAAP

The following summary sets out the significant differences between the Company's reported shareholders' equity under Canadian GAAP as compared to US GAAP. Please see corresponding explanatory notes for additional information.

	As at June 30,		As at December 31,	
	2009	2008	2009	2008
	\$	\$	\$	\$
Shareholders' equity in accordance with Canadian GAAP	<b>3,369</b>	21,475		
Net impact of liability accounting for warrants	(a) <b>(1,586)</b>	-		
In-process research and development costs	(b) <b>(7,821)</b>	(8,341)		
Shareholders' (deficiency) equity in accordance with US GAAP	<b>(6,038)</b>	13,134		

### Statement of cash flows

For the three-month and six-month periods ended June 30, 2009 there were no significant differences between the statements of cash flows under Canadian GAAP as compared to US GAAP.

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### **a) Warrants**

Under Canadian GAAP, the Company has classified and is accounting for its outstanding share purchase warrants as equity, on the basis that these warrants do not embody a contractual obligation on the Company to deliver cash or another financial asset to the holder of these warrants. The conditional written put option that arises upon the occurrence of a Fundamental Transaction, as defined in the warrant and including a change in control, was not considered to be probable under the CICA's Emerging Issues Committee Abstract No. 70, *Presentation of a Financial Instrument Labelled as a Share When a Future Event or Circumstance May Affect the Issuer's Obligations*. Under US GAAP, the Company has determined that the share purchase warrants are within the scope of the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ("SFAS 150"), and as such has classified and is accounting for these instruments as a liability. SFAS 150 states that financial instruments which contain a written put option, even if that repurchase feature is conditional on a defined contingency, should be classified as a liability if such contingency ultimately could result in the transfer of assets by the issuer.

The total warrant liability would be included for US GAAP purposes within the long-term liabilities section of the consolidated balance sheet and carried at fair value, or \$1,821,610 as at June 30, 2009. Any changes to the fair value of the warrant liability would be reflected within other income (expenses) in the consolidated statement of loss.

As at June 30, 2009, the Investor warrants had a fair value of \$1,591,701, which was determined by applying the Black-Scholes pricing model, to which the following assumptions were applied: a market-value per share price of \$1.73, a risk-free annual interest rate of 1.64%, expected volatility of 90.6%, an expected term of 2.5 years and an expected dividend yield of 0.0%.

As at June 30, 2009, the Compensation warrants had a fair value of \$229,909, which was determined by applying the Black-Scholes pricing model, to which the following assumptions were applied: a market-value per share price of \$1.73, a risk-free annual interest rate of 1.64%, expected volatility of 90.6%, an expected term of 2.5 years and an expected dividend yield of 0.0%.

The fair value of the Company's warrant liability was determined using the Black-Scholes pricing model. The valuation methodology uses "Level 2" inputs in calculating fair value, as defined in SFAS No. 157, *Fair Value Measurement*, which establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Level 2 inputs are those which are either directly or indirectly observable as of the reporting date and include financial instruments that are valued using models or other valuation methodologies, such as the Black-Scholes pricing model.

### **b) Research and development costs**

Under US GAAP, prior to the issuance of SFAS 141(R), as defined and discussed below, in-process research and development acquired in a business combination was required to be written off at the time of acquisition. Under Canadian GAAP, in-process research and development acquired in a business combination is capitalized and amortized over its estimated useful life.

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### **New accounting standards and pronouncements**

#### **a) Adopted in 2009**

##### **The FASB's Emerging Issues Task Force ("EITF") Issue No. 07-1, "Accounting for Collaborative Agreements Related to the Development and Commercialization of Intellectual Property" ("EITF 07-1")**

The EITF has issued guidance for accounting for arrangements under which companies participate in the development and commercialization of intellectual property into commercially viable products. The EITF defines a collaborative arrangement as a contractual arrangement that involves a joint operating activity. These arrangements involve two or more parties who are both (a) active participants in the activity and (b) exposed to significant risks and rewards dependent on the commercial success of the activity. A company may receive revenues and incur costs under such arrangements as well as make or receive payments from the other participant in the arrangement. The EITF concluded that revenues earned and costs incurred by a company should be presented gross or net depending on whether the company is the principal participant in the arrangement. The EITF ratified EITF 07-1 in December 2007, making the guidance effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company has adopted the provisions of EITF 07-1 on January 1, 2009, and such adoption has not had any impact on the Company's consolidated financial statements.

##### **Statement of Financial Accounting Standard ("SFAS") No. 141 (revised 2007), *Business Combinations*, ("SFAS 141(R)")**

In December 2007, the FASB issued SFAS No. 141(R), which is a revision of previously existing guidance on accounting for business combinations. SFAS 141(R) retains the fundamental concept of the purchase method of accounting and introduces new requirements for the recognition and measurement of assets acquired, liabilities assumed and non-controlling interests. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company will apply the provisions of SFAS 141(R) to any business combinations entered into in the future.

##### **SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51***

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* ("SFAS 160"). SFAS 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method significantly changes the accounting for transactions with minority interest holders. SFAS 160 is effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will apply the provisions of SFAS 160 to any business combinations entered into, where applicable, in the future.

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### ***SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – Including an amendment of FASB Statement No. 133 (“SFAS 161”)***

In March 2008, the FASB issued SFAS No. 161, which amends and expands the disclosure requirements in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and other related literature. SFAS 161 is effective for financial statements issued for periods beginning after November 15, 2008. The Company has adopted SFAS 161 on January 1, 2009, and there has been no impact on the Company’s consolidated financial statements.

### ***SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (“SFAS 162”)***

In May 2008, the FASB issued SFAS 162, which is intended to improve financial reporting by identifying a consistent framework for selecting accounting principles to be used in preparing financial statements that are presented in conformity with US GAAP for non-governmental entities. The guidance in SFAS 162 replaces that which is prescribed by the American Institute of Certified Public Accountants’ (“AICPA”) Statement on Auditing Standards (“SAS”) No. 69, “The Meaning of *Present Fairly in Conformity with Generally Accepted Accounting Principles*, for Nongovernmental Entities”. SFAS 162 became effective in January 2009, and the adoption of this standard has not had any impact on the Company’s consolidated financial statements.

### ***SFAS 165, Subsequent Events (“SFAS 165”)***

In May 2009, the FASB issued SFAS 165, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. The Company adopted SFAS 165 in May 2009, and such adoption has not had any impact on the Company’s consolidated financial statements.

### ***FASB Staff Position (“FSP”) No. FAS 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP FAS 142-3”)***

On April 25, 2008, the FASB issued FSP FAS 142-3, which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R and as per other US GAAP guidance. FSP FAS 142-3 is effective for financial years beginning after December 15, 2008 and interim periods within those fiscal years. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. The Company adopted FSP FAS 142-3 on January 1, 2009, and there has been no impact on the Company’s consolidated financial statements.

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### **FSP No. FAS 107-1 and Accounting Principles Board (“APB”) Opinion 28-1, “Interim Disclosures About Fair Value of Financial Instruments” (“FSP FAS 107-1 and APB 28-1”)**

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, which amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for annual and interim reporting periods of publicly traded companies and amends APB 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. The Company has adopted FSP FAS 107-1 and APB 28-1 in April 2009, and such adoption has not had a significant impact on the Company’s financial statements.

### **FSP No. FAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies” (“FSP FAS 141(R)-1”)**

On April 1, 2009, the FASB issued FSP FAS 141(R)-1, which amends and clarifies SFAS 141R to address application issues raised with respect to initial recognition and measurement, subsequent measurement and accounting and disclosure of assets and liabilities arising from contingencies in a business combination. FSP FAS 141(R)-1 is effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will adopt FSP FAS 141(R)-1, where relevant, for any future business combinations entered into.

### **FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (“FSP FAS 157-4”)**

In April 2009, the FASB issued FSP FAS 157-4, which provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. FSP FAS 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009, while earlier adoption for periods ending before March 15, 2009, is not permitted. The Company adopted FSP FAS 157-4 on April 1, 2009, and there has been no significant impact on the consolidated financial statements.

### **EITF Topic D-101: *Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142* (“Topic D-101”)**

The EITF updated Topic D-101 to include references to SFAS 141R, which applies to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will apply the provisions of SFAS Topic D-101, where applicable, to any future business combinations entered into.

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### **b) Not yet adopted**

#### **FSP No. FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets” (“FSP FAS 132(R)-1”)**

On December 30, 2008, the FASB issued FSP FAS 132(R)-1, which significantly expands the disclosures required by employers for postretirement plan assets. FSP FAS 132(R)-1 requires plan sponsors to provide extensive new disclosures about assets in defined benefit postretirement benefit plans as well as any concentrations of associated risks. FSP FAS 132(R)-1 also requires new disclosures similar to those in SFAS No. 157, *Fair Value Measurements*, in terms of the three-level fair value hierarchy, including a reconciliation of the beginning and ending balances of plan assets that fall within Level 3 of the hierarchy. FSP FAS 132(R)-1 is effective for periods ending after December 15, 2009, and the pertinent disclosure requirements are annual and do not apply to interim financial statements. The Company is currently evaluating the potential impact, if any, that the adoption of FAS 132(R)-1 will have on its consolidated financial statements.

#### **SFAS 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* (“SFAS 166”)**

In June 2009, the FASB issued SFAS 166, which removes the concept of a qualifying special-purpose entity from Statement 140 and removes the exception from applying FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, to qualifying special-purpose entities. SFAS 166 must be applied as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. The Company does not expect that adoption of this standard will have a significant impact on the consolidated financial statements.

#### **SFAS 167, *Amendments to FASB Interpretation No. 46(R)* (“SFAS 167”)**

In June 2009, the FASB issued SFAS 167, which amends the consolidation guidance for variable interest entities under FASB Interpretation No. 46(R). Amendments include the elimination of the exemption for qualifying special purpose entities, a new approach for determining who should consolidate a variable-interest entity and changes to when it is necessary to reassess who should consolidate a variable-interest entity. SFAS 167 is effective for years beginning after November 15, 2009, for interim periods within those years, and for interim and annual reporting periods thereafter. The Company does not expect that adoption of this standard will have a significant impact on the consolidated financial statements.

#### **SFAS 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162* (“SFAS 168”)**

In June 2009, the FASB issued SFAS 168, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities presented in conformity with US GAAP. SFAS 168 replaces SFAS 162 and is effective for interim and annual periods ending after September 15, 2009. The Company does not expect that adoption of this standard will have a significant impact on the consolidated financial statements.

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### **SEC Staff Accounting Bulletin (“SAB”) No. 112 (“SAB 112”)**

In June 2009, the SEC issued SAB 112, which amends or rescinds portions of the interpretive guidance included in the Staff Accounting Bulletin Series in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations, and in order to bring existing guidance into conformity with recent pronouncements by the FASB, namely, SFAS 141R and SFAS 160. SAB 112 will be effective upon publication in the Federal Register. The Company does not expect that adoption of this SAB will have a significant impact on the consolidated financial statements.