District of British Columbia
Division No. 03 - Vancouver
Court No.
Estate No. 11-1753091

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE PROPOSAL OF
ALLON THERAPEUTICS INC.

TRUSTEE'S PRELIMINARY REPORT TO CREDITORS

BACKGROUND

Allon Therapeutics Inc. ("Allon" or the "Company") is a clinical-stage biotechnology company focused on developing and bringing to market central nervous system therapies. In September 2004, the Company acquired a 100% interest in a United States based business called Allon Therapeutics, Inc. ("Allon US"). The Company then changed its name from Neuro Discovery Inc. to Allon Therapeutics Inc. and focused the business on the development of Allon's technology. Allon currently has six employees and is carrying on operations from its head office at 1168 Hamilton Street in Vancouver, British Columbia. The Company's shares are listed on the Toronto Stock Exchange (TSX:NPC) and are held by a broad base of investors.

Over the last two years, Allon's primary activity has been the development of a candidate drug called Davunetide for the treatment of an orphan indication called progressive supranuclear palsy ("PSP"). Allon had previously carried out extensive clinical trials of Davunetide in compliance with regulatory agencies in the United States and Canada. The most recent clinical trial in PSP was required in order to show the efficacy and safety of the drug in PSP patients before an approval application could be submitted for sale and distribution of Davunetide. The trial included centres in six countries, enrolling 313 patients diagnosed with PSP.

On December 18, 2012 the Company announced that its pivotal clinical trial evaluating Dauvunetide as a treatment for PSP failed to demonstrate efficacy in this population. In addition,

the study examined a series of secondary and exploratory endpoints. There was no evidence of a drug effect on these secondary or exploratory endpoints.
After the failure of the clinical trial, the Company commenced an evaluation of its strategic options and ceased funding any further research and development activities for Davunetide. The Company also took immediate action to reduce its on-going operating expenses, including a 40% reduction in its staff.

The strategic review process included the consideration of all reasonable options for monetizing Allon's assets, as well as securing additional financing. Due to the failure of the clinical trial, financing further research, development and commercialization of Davunetide or the Company's earlier stage drug candidates proved very difficult. The Company continued to incur operating costs and faced declining liquidity as a result. Accordingly, Allon concluded that it was in its best interests to seek creditor protection under the *Bankruptcy and Insolvency Act* ("BIA"), with a view to reorganizing its capital structure and continuing as a going concern by filing a proposal under Part III, Division I of the BIA (the "Proposal"). Under the terms of the Proposal, it is contemplated that the Company will be sold to Paladin Labs Inc. ("Paladin") for consideration of $900,000. The Company filed the Proposal with the Office of the Superintendent of Bankruptcy on May 29, 2013.

The most recent audited financial statements for the year ended December 31, 2012 indicate that the Company incurred a net loss of $14.92 million, compared to a net loss of $12.77 million in 2011. The Company continues to incur operating costs and reported a comprehensive loss of $1.07 million in the three months ended March 31, 2013. As at March 31, 2013 the Company reported cash and cash equivalents of $589,484.

The Company's Statement of Affairs shows $3.39 million in unsecured liabilities outstanding at the time of the filing of the Proposal.

STRATEGIC OPTIONS ASSESSMENT

During the 24 month period prior to the Company's clinical trial results, management held numerous discussions to explore potential partnership transactions and joint venture arrangements with approximately twelve global pharmaceutical companies, regional neurology specialty companies and companies focused on the orphan space. However, the Company received consistent feedback that there would only be interest on commercially acceptable terms if the pivotal study was positive.

Upon determining on December 17, 2012 that the clinical trial had failed, the Company conducted additional data analysis in the subsequent weeks. However, these analyses did not show any further efficacy or provide greater clarity as to why the study failed.

Beginning in January 2013, Allon undertook a broad assessment of the strategic options available to the Company focused on finding parties interested in pursuing further work on the data and samples generated during the trial, or interested in acquiring Allon's pipeline products and/or the intellectual property portfolio. The Company also explored potential merger or acquisition transactions.

Over the course of a four month search for potential parties, the Company had discussions with approximately 20 interested parties. The Company also had discussions with several advisors in an attempt to find potential acquirers of some or all of the assets of the Company. Although a number of interested parties conducted due diligence, in the most part the discussions were unsuccessful, either due to lack of proximity to commercialization of Davunetide, the requirement for additional capital raising to support further development of other pipeline products, or due to the compressed timescale required to effect a transaction given the Company's declining financial position.

Only two potential transactions progressed to an advanced stage:

- A sale of the Company to Paladin as contemplated in the Proposal ("Paladin Transaction"); and
- A sale of the Company to a third party on terms broadly equivalent to those discussed with Paladin. Despite advanced negotiations and due diligence being undertaken, the Company had concerns over the ability of this party to effect a transaction within the timelines required. In addition, after further attempts to progress discussions, the interested party was ultimately not able or willing to proceed with a transaction.

The Company also held discussions with several investment banks and financial advisors, each of whom reconfirmed that due to the negative results of the clinical trial, the Company was unlikely to be financeable at this time.

ESTIMATED FINANCIAL POSITION

The total assets and liabilities of the Company as reported in its Statement of Affairs dated May 29, 2013 are:

Assets	$209,117
Liabilities	$3,386,042

As of the date of its Statement of Affairs, the Company had $172,622 in cash or cash equivalents. As reflected on the cash flow projection prepared by management for the period of May 27, 2013 to July 26, 2013, this balance is expected to reduce to approximately $2,400 by the end of the cash flow projection period. The projected expenses incurred during this period include operating costs, rent, payroll and funding provided to the Trustee to be deposited into the Estate trust account for the purpose of covering the costs of administering the Estate.

The Company also holds a 100% interest in Allon US. The assets of Allon US are:

- An inter-company receivable from the Company. Allon US will not be making a claim in the Proposal and is therefore excluded from the Company's Statement of Affairs;
- Miscellaneous computer equipment with a book value of approximately $700; and
- Miscellaneous intellectual property and patents related to the Company's drug candidate with a net book value of nil.

For the purposes of the Statement of Affairs, management has estimated that the Company's investment in Allon US has no realizable value.

In addition to the intellectual property owned by Allon US, the Company holds further patents and intellectual property with a net book value of nil. The patents and other intellectual property held by the Company and Allon US are valued at nil as a result of the clinical results for the Company's only drug candidate failing to show efficacy, which eliminated any future investment prospects to continue advancement of the drug, as discussed earlier in this report.

Other assets of the Company disclosed in its Statement of Affairs include:

- A deposit held by a supplier in the amount of $30,000. This is expected to be recovered in full and is included in the Company's cash flow projection;
- GST receivable of $6,492 which has also been included in the Company's cash flow projection;
- Prepaid insurance and deposits of $12,174; and
- A fully encumbered photocopier leased from Xerox Canada Ltd.

A search of the Personal Property Security Registry has not revealed any charges registered against any other assets registered in the Company's name.

SUMMARY OF PROPOSAL

A copy of the detailed Proposal is included as an enclosure. The terms of the Proposal are summarized as follows:

1. THAT the Company will become a wholly-owned subsidiary of Paladin.

2. THAT as part of the proposed transaction with Paladin, all currently issued shares in the Company will be cancelled and Paladin will be issued new common shares or a combination of new common shares and debt securities in the Company.

3. THAT in consideration of the transaction, Paladin is to make a cash payment of $900,000 which, after deducting Proposal and transaction costs, is to be used to fund this Proposal and be available for distribution to creditors with priority and unsecured claims.

4. THAT if accepted by the proven creditors and the Supreme Court of British Columbia (the "Court"), the Proposal would become binding on the Company, the Company's shareholders and all creditors.

5. THAT priority claims will be paid as follows:

    (i) The claims of Her Majesty the Queen in right of Canada or of any province for unremitted employee remittances for income tax, Canada Pension Plan or Employment Insurance and of any related interest, penalties or other amounts that were outstanding at the time of the filing of the Proposal shall be paid in their entirety, without interest, within six months after the approval of the Proposal.

    (ii) The claims of any employee who is owed wages, salaries, commissions or compensation for services rendered during the period beginning on the day that is six months before the date of the filing of this Proposal up to a maximum of $2,000 will be paid in their entirety as soon as reasonably practicable after the approval of the Proposal.

    (iii) All Proposal costs, including Trustee costs and obligations as well as legal and financial advisor fees are to be paid in their entirety.

6. THAT costs and debts incurred after the filing of the Proposal and before the completion of the transactions proposed in the Proposal, including employee wages, will be paid in full on their respective due dates and shall be paid in priority to all claims of the priority and unsecured creditors.

7. THAT the Company will disclaim its office lease and the landlord affected by that disclaimer may file a proof of claim for its actual losses, if any, resulting from the disclaimer by the Company subject to the landlord's duty to mitigate its damages. For the purposes of voting at the Creditors' Meeting, the landlord will be classified as an unsecured creditor.

8. THAT each unsecured creditor will, in full and final satisfaction of its claims, be paid:

   (i) the first $1,000.00 of its proven claim; and

   (ii) then be paid an amount determined by applying the following formula;

$$\begin{array}{c}\text{The total amount available}\\ \text{to distribute to unsecured}\\ \text{creditors after deducting}\\ \text{for all amounts discussed}\\ \text{in Paragraphs 5 to 8(i)}\\ \text{above}\end{array} \quad \mathrm{X} \quad \frac{\begin{array}{c}\text{The amount of the unsecured}\\ \text{creditor's proven claim (less the}\\ \text{amount of \$1,000.00 paid first)}\end{array}}{\begin{array}{c}\text{The total amount of all unsecured}\\ \text{creditor's proven claims}\end{array}}$$

9. THAT all distributions for proven claims will be net of the statutorily required 5% Office of the Superintendent of Bankruptcy's levy ("OSB Levy").

10. THAT the unsecured creditors shall agree to accept the amounts realizable and payable in full settlement and satisfaction of the balances owing to them on their provable claims against the Company under the BIA.

FINANCIAL INFORMATION TO EVALUATE THE PROPOSAL

A Statement of Estimated Realizations comparing the estimated outcome for unsecured creditors under both the terms of the Proposal and in the event of a Bankruptcy scenario is enclosed as **Appendix A**. The estimated amount available for distribution to creditors is as follows:

Proposal	$790,000
Bankruptcy	$nil ("Low" scenario) to $81,000 ("High" scenario")

Based on the listing of unsecured creditors included in the Company's Statement of Affairs, under the Proposal it is estimated that approximately twelve creditors with claims less than, or equal to $1,000 will receive payment in full, less the OSB Levy. In addition, those creditors with claims exceeding $1,000 are estimated to receive $1,000 plus approximately $0.21 for every $1.00 claimed over $1,000, less the OSB Levy.

In a Bankruptcy scenario, the ability of a Bankruptcy Trustee to realize any significant proceeds from the sale of the Company's intellectual property or other assets is likely to be significantly restricted. As discussed earlier in this report, the Company has previously undertaken an extensive sale process exploring all options for realizing value from the Company. The impact of a Bankruptcy is likely to further weaken interest in the Company's assets and will compromise the ability of any potential purchaser to utilize the Company's accrued tax losses. The estimated amount available for distribution to creditors under a Bankruptcy scenario of $nil to $81,000 is approximately equivalent to a dividend of between $nil to $0.02 for every $1.00 claimed by unsecured creditors.

In summary, the Trustee is of the view that the return to unsecured creditors under the Proposal will significantly exceed the likely return in a Bankruptcy scenario.

CONDUCT OF THE COMPANY

Prior to the filing of the Proposal, the Trustee has undertaken a limited financial review of the Company's operations and has had discussions with management regarding financial matters. The Trustee has not undertaken any examinations to identify preference transactions, settlements or other reviewable transactions. The Proposal filed by the Company specifically waives the applicability of Sections 91 to 101 of the BIA.

PREVIOUS BUSINESS DEALINGS WITH THE COMPANY

Deloitte & Touche Inc. has had no previous business dealings with the Company and has no known conflict of interest.

REMUNERATION OF THE TRUSTEE

The Trustee's fees and disbursements will be paid from the funds available in the Proposal based on the time and expenses incurred, subject to taxation by the Court. The Trustee estimates that its fees will amount to approximately $95,000 depending on the number and complexity of the creditor claims received in the Proposal and the timely progression of the Proposal process. The Proposal contemplates that the Trustee will be authorized to draw fees as they are incurred, upon Court approval of the Proposal, subject to taxation by the Court upon completion of the administration of the estate.

TIMING AND PROCESS

A formal meeting of creditors to consider and vote on the acceptance or rejection of the Proposal is scheduled for June 12, 2013 at the offices of the Trustee.

The Proposal has to be accepted by a majority in number and two-thirds of the value of creditors' claims, either present and voting in person or by proxy, or otherwise voting by voting letter.

Upon approval of the Proposal by the creditors, an application will be made to Court for an order approving the Proposal. The Court will set a date to hear the application and notice of the Court hearing will then be sent to every creditor with a proven claim.

Following Court approval of the Proposal and the closing of the Paladin Transaction, all funds to be distributed to creditors will be paid to the Trustee. The Trustee will in turn make all payments to creditors with proven claims in accordance with the Proposal.

Should the motion in support of the Proposal not gain the required statutory creditor majorities, the Company will be automatically deemed to have made an Assignment in Bankruptcy. In such a scenario the creditors may elect to retain the Trustee to administer the Estate or may substitute a new Trustee in Bankruptcy.

VOTING ON THE PROPOSAL

It is required that all creditors who wish to vote on this Proposal forthwith submit to the Trustee a completed proof of claim with a statement of account supporting the claim to allow for timely processing. Those creditors who do not plan to attend the meeting in person, or to be represented by proxy, may register their vote on the Proposal by use of the enclosed voting letter. Note that creditors voting by voting letter must also submit a completed proof of claim with a statement of account attached.

In order for a vote and/or proxy to be valid, a proof of claim must be submitted to the Trustee before the scheduled meeting of creditors. Electronic submission is acceptable. You may fax the above documents to the attention of Mr. Ilya Margulis at Deloitte & Touche Inc. (fax (604) 602-1583). It is not necessary to mail original copies to the Trustee.

If accepted and approved by the Court, the Proposal becomes binding on all creditors, whether they voted for or against the Proposal.

TRUSTEE'S RECOMMENDATION

It is the Trustee's opinion that the Proposal is in the best interests of the creditors since it provides for the going concern sale of Allon and a return to the unsecured creditors that will significantly exceed the likely return in a Bankruptcy scenario. The Trustee therefore recommends that the creditors accept the Company's Proposal. The Trustee intends to vote any proxies naming the Trustee in favor of the Proposal.

DATED AT the City of Vancouver, in the Province of British Columbia, this 30th day of May, 2013.

DELOITTE & TOUCHE INC.
In its capacity as the Trustee under
the Proposal of Allon Therapeutics Inc.
and not in its personal capacity

Huey Lee, MBA, CMA, CIRP
Senior Vice President

Allon Therapeutics Inc.

Appendix A

Statement of Estimated Realizations
(CDN$'000)

	Proposal	Bankruptcy Low	Bankruptcy High	Notes
Estimated Asset Realizations				
Sale of Company including all Intellectual Property	900	-	100	*1*
Cash and Cash Equivalents	2	45	56	*2*
Estate trust account funded by Company	95	50	50	*3*
GST Receivable	-	-	6	*4*
Furniture & Equipment	-	-	1	*5*
Prepaid Expenses	-	-	6	*6*
Total Asset Realizations	**997**	**95**	**219**	
Priority Claims	-	(4)	(4)	*7*
Estimated Liquidation Costs				
Trustee Fees	(95)	(81)	(120)	*8*
Contingency for other costs	(10)	(10)	(10)	
Financial Advisor Fee	(60)	-	-	*9*
Total Liquidation Costs	**(165)**	**(91)**	**(130)**	
Estimated Net Realizations	**832**	**-**	**85**	
Levy (5%)	(42)	-	(4)	
Available for distribution to Unsecured Creditors	**790**	**-**	**81**	
Unsecured Creditor claims per Statement of Affairs	3,386	3,386	3,386	*10*
Estimated deficiency to Unsecured Creditors	**(2,596)**	**(3,386)**	**(3,305)**	

Notes:

1) Under the Proposal, is is intended that Paladin will acquire all the assets of the Company for consideration of $900,000. Under a Bankruptcy scenario, it is likely that realizations from any sale of the Company's intellectual property and/or tax losses will be significantly reduced. An indicative range of $nil to $100,000 is included for the purposes of this analysis.

2) Under the Proposal, management estimate that there will be cash on hand of $2,000 as at the proposed transaction completion date of July 26, 2013. Under the "High" Bankruptcy scenario, it is assumed that a Deemed Bankruptcy occurs following the Meeting of Creditors at the end of Week 3 in management's forecast cash flow (cash balance of $56,000). The "Low" Bankruptcy scenario allows for a contingency of $11,000, reflecting a small potential variance in management's estimated cash flow forecast.

3) These amounts represent funds provided by the Company to the Trustee to be deposited into the Estate trust account in advance of the Proposal being approved by the creditors and Court. These funds are to be provided for the purpose of covering the costs of administering the estate.

4) Under the Proposal scenario, the GST Receiveable of $6,000 is included within the cash balance of $2,000 as at the projected transaction completion date. In the Bankruptcy scenario, it is assumed that between $nil to $6,000 is recoverable from Canada Revenue Agency.

5) Realizations from furniture & equipment are likely to be minimal. The Company's photocopier is fully encumbered. Under the Bankruptcy scenario a range of $nil to $1,000 is assumed.

6) Under the Bankruptcy scenario, recoveries from prepaid expenses are estimated at between $nil to $6,000 (50% of net book value).

7) Under the Proposal, employees will be paid wages to their proposed termination dates (no wages outstanding, therefore no priority claims). In the Bankruptcy scenario, it is assumed that employees are terminated early with wages owing. There are two employees that are in non-officer positions who would be eligible for priority claims under BIA subsection 81.3.

8) Trustee fees related to the Proposal are estimated at approximately $95,000 which will be drawn, as incurred, from the estate trust account upon approval of the Proposal by the Court. Under a Bankruptcy scenario it is estimated that Trustee fees may amount to approximately $81,000 under the "Low" scenario and $120,000 under the "High" scenario, reflecting the additional effort required to effect a sale of the Company's intellectual property and tax losses. Trustee fees are based on actual time and fees incurred and are subject to taxation by the Court.

9) The financial advisor fee reflects the amount payable to Cantor Fitzgerald Canada Corporation upon the successful completion of a transaction with Paladin.

10) The amount shown as owing to unsecured creditors is as per the Company's Statement of Affairs. Actual proven claims may differ from the amount shown.

It should be noted that our estimates are indicative only. Realizations have been estimated based on discussions with management and management's Statement of Affairs, in addition to the various assumptions as set-out in the notes above. Readers are cautioned that actual realizations will vary and variations could be material. Deloitte & Touche Inc. has not audited, reviewed or otherwise verified this information.