



**KANE BIOTECH INC.  
FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007**

5-1250 Waverley Street  
Winnipeg, Manitoba, R3T 6C6  
Tel: (204) 453-1301 Fax: (204) 453-1314  
[www.kanebiotech.com](http://www.kanebiotech.com)



**KPMG LLP**  
**Chartered Accountants**  
Suite 2000 – One Lombard Place  
Winnipeg MB R3B 0X3  
Canada

Telephone (204) 957-1770  
Fax (204) 957-0808  
Internet [www.kpmg.ca](http://www.kpmg.ca)

## AUDITORS' REPORT

To the Shareholders of Kane Biotech Inc.

We have audited the balance sheets of Kane Biotech Inc. as at December 31, 2008 and 2007 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed “**KPMG LLP**”

Chartered Accountants

Winnipeg, Canada

April 27, 2009



# KANE BIOTECH INC.

## Balance Sheets

December 31, 2008 and 2007

	2008	2007
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 548,983	\$ 344,511
Accounts receivable	101,260	36,352
Prepaid expenses (Note 11)	43,800	24,489
	694,043	405,352
Property and equipment (Note 6)	71,108	101,197
Intangible assets (Note 7)	807,160	722,043
	\$ 1,572,311	\$ 1,228,592
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities (Note 11)	\$ 79,562	\$ 87,858
Shareholders' equity:		
Capital stock (Note 8(b))	5,548,574	4,794,288
Warrants (Note 8(d))	735,682	70,138
Contributed surplus (Note 8(e))	623,177	614,148
Deficit	(5,414,684)	(4,337,840)
	1,492,749	1,140,734
Nature and continuation of operations (Note 1)		
Commitments and contingencies (Note 10)		
Subsequent event (Note 15)		
	\$ 1,572,311	\$ 1,228,592

On behalf of the Board:

Director

Director

The accompanying notes are an integral part of these financial statements



# KANE BIOTECH INC.

## Statements of Operations and Deficit Years ended December 31, 2008 and 2007

	2008	2007
<b>Expenses</b>		
General and administration (Note 11)	487,228	458,648
Research (Note 11)	520,304	357,375
Amortization	42,285	51,021
Write-down of patents (Note 7)	53,220	54,838
Stock-based compensation		
General and administration	454	118,907
Research	-	66,322
Loss before the undernoted	(1,103,491)	(1,107,111)
<b>Other</b>		
Investment income	26,647	17,156
Loss and comprehensive loss for the year	(1,076,844)	(1,089,955)
Deficit, beginning of year	(4,337,840)	(3,247,885)
Deficit, end of year	\$ (5,414,684)	\$ (4,337,840)
Basic and diluted loss per share (Note 8(g))	\$ (0.04)	\$ (0.06)

The accompanying notes are an integral part of these financial statements



# KANE BIOTECH INC.

## Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
<b>Cash provided by (used in):</b>		
<b>Operating activities:</b>		
Loss and comprehensive loss for the year	\$ (1,076,844)	\$ (1,089,955)
Adjustments for:		
Amortization of property and equipment	30,089	33,001
Amortization of patents	12,196	18,020
Write-down of patents	53,220	54,838
Gain on disposal of property and equipment	-	(517)
Stock-based compensation	454	185,229
Change in the following:		
Accounts receivable	(64,908)	20,904
Prepaid expenses	(19,311)	(14,922)
Accounts payable and accrued liabilities	(8,296)	(4,975)
	(1,073,400)	(798,377)
<b>Financing activities:</b>		
Issuance of common shares, net of share issue costs	1,428,405	620,687
<b>Investing activities:</b>		
Purchase of property and equipment, net of proceeds on disposal	-	(1,134)
Patent and trademark costs	(150,533)	(156,059)
Addition to technology licenses	-	(10,000)
	(150,533)	(167,193)
Increase (decrease) in cash	204,472	(344,883)
Cash and cash equivalents, beginning of year	344,511	689,394
Cash and cash equivalents, end of year	\$ 548,983	\$ 344,511
<b>Supplemental cash flow information:</b>		
Non-cash financing activities:		
Warrants issued as share issue costs	\$ 57,290	\$ 8,575

The accompanying notes are an integral part of these financial statements

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 1. Nature and continuation of operations:

Kane Biotech Inc. (the "Company") was established to use a patent protected technology intended to find compounds which prevent or disrupt biofilms in medical and industrial applications. To date, the Company has no products in commercial production or use. Accordingly, the Company is considered to be a development stage enterprise for accounting purposes. Since May 17, 2001, the date of incorporation of Kane Biotech Inc., through to December 31, 2008, the Company has expended approximately \$2,394,213, net of government assistance, on research.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") that are applicable to a going concern, which contemplates that Kane Biotech Inc. will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. The Company has experienced operating losses and cash outflows from operations since inception. The use of these principles may not be appropriate because at December 31, 2008 there was substantial doubt that the Company will be able to continue as a going concern without raising additional financial resources.

The Company's future operations are completely dependent upon its ability to generate product sales, negotiate collaboration or licence agreements with upfront payments, obtain research grant funding, defer expenditures, or other strategic alternatives, and/or secure additional funds. While the Company is striving to achieve the above plans, there is no assurance these and other strategies will be achieved or that such sources of funds will be available or obtained on favourable terms.

The Company's ability to continue as a going concern is dependent on its ability to obtain sufficient funds to conduct its research and development, and to successfully commercialize its products. The outcome of these matters cannot be predicted at this time. These financial statements do not reflect adjustments to the carrying values of the assets and liabilities, expenses, and the balance sheet classification used, that would be necessary if the going concern assumption were not appropriate. Such adjustment could be material.

### 2. Significant accounting policies:

#### (a) Cash and cash equivalents:

Cash and cash equivalents include cash on hand and balances with banks as well as highly liquid short-term investments. The Company considers all highly liquid short-term investments with terms to maturity when acquired of three months or less to be cash equivalents.

#### (b) Property and equipment:

Property and equipment are stated at cost. Amortization is recorded over the estimated useful lives of the assets at the following rates:

Asset	Basis	Rate
Computer equipment	Diminishing balance	30%
Scientific equipment	Diminishing balance	20%
Office equipment	Diminishing balance	20%
Leasehold improvements	Straight-line	5 years

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**2. Significant accounting policies (continued):****(c) Patents and trademarks:**

Costs incurred in obtaining a patent or trademarks are capitalized and amortized on a straight-line basis over the legal life of the respective patent or trademark, being approximately twenty years, or its economic life, if shorter. The cost of servicing the Company's patents and trademarks is expensed as incurred. Amortization of patent costs began in 2003 for those patent applications approved in the year.

**(d) Technology licenses:**

Technology licenses are recorded at cost. The cost of technology licenses will be amortized over a three year period commencing in the period in which sales of the licensed product are first earned.

**(e) Impairment of long-lived assets:**

The carrying amount of long-lived assets which includes property and equipment and intangible assets to be held and used is reviewed for impairment on an ongoing basis whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment is recognized when the carrying amount of an asset to be held and used exceeds the projected undiscounted future net cash flows expected from its use and disposal, and is measured as the amount by which the carrying amount of the asset exceeds its fair value.

**(f) Financial instruments:**

All financial instruments are classified into one of the following five categories: available for sale, loans and receivables, other financial liabilities, held-for-trading or held-to-maturity. Initial measurement of financial instruments is at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification.

The Company utilizes various financial instruments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency, or credit risks arising from these financial instruments and the carrying amounts approximate fair values. All transactions related to financial instruments are recorded on a trade date basis. All derivatives, including embedded derivatives, that must be separately accounted for, are recorded at fair value in the balance sheet.

The Company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

**Held-for-trading**

This category is comprised of cash and investments in term deposits. They are carried in the balance sheet at fair value with changes in fair value recognized in the statement of operations and deficit. Transaction costs related to instruments classified as held-for-trading are expensed as incurred.

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**2. Significant accounting policies (continued):****(f) Financial instruments (continued):****Loans and receivables**

Loans and receivables consist of accounts receivable and are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. They arise principally through grants (accounts receivable), but also incorporate other types of contractual monetary assets. They are initially recognized at fair value (which approximates cost) and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment. Transaction costs related to loans and receivables are expensed as incurred.

**Other financial liabilities**

Other financial liabilities comprise accounts payable and accrued liabilities. These liabilities are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method. Transaction costs related to other financial liabilities are expensed as incurred.

The Company has not classified any assets or liabilities as held-to-maturity or as available-for-sale. The Company had no "other comprehensive income or loss" transactions during the year ended December 31, 2008 and no opening or closing balances for accumulated other comprehensive income or loss.

**(g) Stock-based compensation:**

The Company has a stock option plan [note 8(c)] for its directors, management, employees, management company employees and consultants. The Company uses the fair value based method to account for all stock-based compensation and other stock-based payments. The fair value is estimated at measurement date using the Black-Scholes option pricing model. For all options granted to directors, management, employees, management company employees and consultants under the Company's stock option plan, compensation expense is recognized over the period(s) in which the related services were rendered.

**(h) Research and development:**

All costs of research activities are expensed in the period in which they are incurred. Development costs are charged as an expense in the period incurred unless the Company believes a development project meets stringent criteria for deferral and amortization. No development costs have been deferred to date.

**(i) Government assistance and investment tax credits:**

Government assistance toward current expense is recorded as a reduction against the related expenses in the period they are incurred and is recognized when there is reasonable assurance that the Company has met the requirements of the approved grant program. Government assistance towards capital assets is deducted from the cost of the related asset. Investment tax credits relating to scientific research and experimental development are recorded as either a reduction of the applicable capital assets or credited in the statement of operations depending on the nature of the expenditures which gave rise to the credits. The investment tax credit is recorded in the period that the credit has been approved by Canada Revenue Agency.

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**2. Significant accounting policies (continued):****(j) Income taxes:**

The Company uses the asset and liability method to provide for income taxes in the financial statements. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. When realization of future income tax assets does not meet the more likely than not criterion then a valuation allowance is provided for the difference.

**(k) Per share amounts:**

Per share amounts are computed using the weighted average number of shares outstanding during the period including contingently issuable shares where the contingency has been resolved. The diluted per share amounts are calculated based on the weighted average number of common shares outstanding during the period, plus the effect of dilutive common share equivalents such as options and warrants. This method requires that diluted per share amounts be calculated using the treasury stock method, as if all the common share equivalents where the average market price for the period exceeds the exercise price had been exercised at the beginning of the reporting period, or at the date of issue, if later, as the case may be, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period.

**(l) Use of estimates:**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Significant estimates are used in determining, but are not limited to, research costs, stock-based compensation, and valuation of patents and trademarks and technology licenses. Actual results could differ from those estimates.

**3. New Accounting Standards adopted during the year:**

The Company adopted the following CICA Handbook standards: Section 1400 "General Standards of Financial Statement Presentation", Section 1535 "Capital Disclosures", Section 3862, "Financial Instruments - Disclosure", and Section 3863, "Financial Instruments – Presentation", on January 1, 2008.

**General standards of financial statement presentation:**

On a regular basis, management assesses the ability of the entity to continue as a going concern. Management is required to make an assessment of an entity'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, twelve months from the balance sheet date. Disclosure is required of any material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. These disclosures are included in Note 1.

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**3. New Accounting Standards adopted during the year (continued):****Capital disclosures:**

Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any regulatory capital requirements and, if it has not complied, the consequences of such non-compliance. These new disclosures are included in Note 13.

**Financial instruments:**

Section 3862, Financial Instruments - Disclosure replaces the disclosure standards of Section 3861. The section requires disclosure, by class of financial instrument, that enables users to evaluate the significance of financial instruments to an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable.

Section 3863, Financial Instruments - Presentation replaces the presentation standards of Section 3861. The existing requirements on presentation of financial instruments have been carried forward unchanged to Section 3863.

These new disclosures are included in Notes 5 and 14.

**4. Recent accounting pronouncements:****(a) Goodwill and intangible assets:**

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets effective for interim and annual periods on or after October 1, 2008. Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research & Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The provisions relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions of IAS 38, Intangible Assets. This new standard is effective for the Company's interim and annual financial statements commencing on January 1, 2009. The Company is assessing the impact of the new standard on its financial statements.

**(b) Convergence to International Financial Reporting Standards ("IFRS"):**

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB's strategic plan outlines the convergence of Canadian GAAP with IFRS over a five-year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company's first year end under IFRS will be December 31, 2011. The transition date for the Company will be January 1, 2011 and will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for fiscal 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 5. Financial instruments:

The Company has classified its financial instruments as follows:

	December 31, 2008	December 31, 2007
Financial assets:		
Cash and cash equivalents (Held-for-trading)	\$ 548,983	\$ 344,511
Accounts receivable (Loans and receivables)	101,260	36,352
	<u>\$ 650,243</u>	<u>\$ 380,863</u>
Financial liabilities:		
Accounts payable and accrued liabilities (Other financial liabilities)	\$ 79,562	\$ 87,858

The Company had neither available-for-sale, nor held-to-maturity financial instruments during the years ended December 31, 2008 or 2007. Cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities are financial instruments whose fair value approximates their carrying value due to their short-term maturity.

### 6. Property and equipment:

December 31, 2008	Cost	Accumulated amortization	Net book value
Computer and office equipment	\$ 12,199	\$ 8,163	\$ 4,036
Scientific equipment	126,321	78,141	48,180
Leasehold improvements	82,789	63,897	18,892
	<u>221,309</u>	<u>150,201</u>	<u>71,108</u>
<hr/>			
December 31, 2007	Cost	Accumulated amortization	Net book value
Computer and office equipment	\$ 12,199	\$ 6,678	\$ 5,521
Scientific equipment	126,321	66,095	60,226
Leasehold improvements	82,789	47,339	35,450
	<u>\$ 221,309</u>	<u>\$ 120,112</u>	<u>\$ 101,197</u>

Included in general and administration expenses is a gain on sale of property and equipment of nil (2007 - \$517).

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 7. Intangible assets:

<b>December 31, 2008</b>	Cost, net of impairments	Accumulated amortization	Net book value
Patents <sup>(1)</sup>	\$ 518,556	\$ 20,322	\$ 498,234
Trademarks	10,776	-	10,776
Technology licenses <sup>(2)</sup>	298,150	-	298,150
	<b>\$ 827,482</b>	<b>\$ 20,322</b>	<b>\$ 807,160</b>

  

<b>December 31, 2007</b>	Cost, net of impairments	Accumulated amortization	Net book value
Patents <sup>(1)</sup>	\$ 442,068	\$ 21,863	\$ 420,205
Trademarks	3,688	-	3,688
Technology licenses <sup>(2)</sup>	298,150	-	298,150
	<b>\$ 743,906</b>	<b>\$ 21,863</b>	<b>\$ 722,043</b>

<sup>(1)</sup> As part of the ongoing review of the Company's portfolio of intellectual property, a write-down of patents equal to \$53,220 (2007 - \$54,838) was recorded to recognize certain applications no longer being pursued and consequently determined to have no future value.

<sup>(2)</sup> The Company has a worldwide exclusive licence to technology from the University of North Texas Health Science Center. The Company is obligated to pay all costs of filing and maintaining patents, pay a royalty of a stipulated percentage on the net sales of licensed products, and pay a stipulated percentage of any sublicense fee. Fees payable, if any, are to be paid quarterly. The agreement terminates on the expiration or invalidity of the last patent issued under the agreement.

On December 31, 2004, the Company acquired the worldwide exclusive rights to the Competence Stimulating Peptide (CSP) technology from the University of Toronto. Under the terms of the agreement, the Company paid an initial license fee of \$30,000 to University of Toronto Innovations Foundation (UTIF) and, in fiscal 2005, issued 165,000 common shares to each of UTIF and the Governing Council of University of Toronto for an aggregate of 330,000 common shares at deemed consideration of \$0.72 per share or \$237,600. The Company is also obligated to pay \$20,000 to UTIF for each patent issued as a result of this license agreement to a maximum of \$40,000 as well as pay for all costs of filing and maintaining the patents. In further consideration of granting of the license, the Company will pay a royalty to UTIF of a stipulated percentage of the net sales of the licensed products. If the Company sub-licenses any rights under the agreement to a third party, the Company shall pay UTIF a stipulated percentage of a sub-license fee and sub-license royalty fee. The royalty, sub-license and sub-license royalty fees, if any, are to be paid quarterly. The agreement terminates on the expiration or invalidity of the last patent issued under the agreement. There were no sales of licensed products to December 31, 2008.

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 7. Intangible assets (continued):

On April 1, 2005, the Company acquired the worldwide exclusive license to all human and industrial applications of the DispersinB<sup>®</sup> enzyme from the University of Medicine and Dentistry of New Jersey (UMDNJ) and paid a license initiation fee of \$11,815 (USD \$10,000). Under the terms of the agreement, the Company committed to: pay all costs of filing and maintaining the patents; pay a license initiation fee of USD \$10,000 during the first year; and, additional negotiated milestone payments throughout the term of the agreement. The Company will also pay a royalty to UMDNJ of a stipulated percentage of the net sales of the licensed products. If the Company sub-licenses any rights under the agreement to a third party, the Company shall pay UMDNJ a stipulated percentage of a sub-license fee and sub-license royalty fee. The royalty, sub-license and sub-license royalty fees, if any, are to be paid quarterly. This agreement terminates on the expiration or invalidity of the last patent issued under the agreement. During fiscal 2006, the Company negotiated an expansion to the scope of the original license agreement with UMDNJ and, as a result, paid an additional fee of \$8,735 (USD \$7,500). During fiscal 2007, as a result of the issuance of a patent, a \$10,000 milestone payment was incurred. The Company began paying an annual minimum royalty fee beginning on April 1, 2008, which was the third anniversary date of the agreement is included in research expenses. There were no sales of licensed products to December 31, 2008.

### 8. Capital stock:

#### (a) Authorized:

The Company has authorized share capital of an unlimited number of common voting shares and an unlimited number of class A common voting shares.

#### (b) Shares issued and outstanding:

Shares issued and outstanding are as follows:

	Number of Common Shares	Amount
Balance, December 31, 2006	17,299,327	\$ 4,243,739
Issued for cash, net of issue costs of nil	54,164	16,249
Issued for cash, net of issue costs of \$74,137 and fair value assigned to warrants of \$61,563 <sup>(1)</sup>	1,675,000	534,300
Balance, December 31, 2007	19,028,491	4,794,288
Issued for cash, net of issue costs of \$178,885 <sup>(2)</sup>	6,200,000	754,286
Balance, December 31, 2008	25,228,491	\$ 5,548,574

<sup>(1)</sup> On August 16, 2007, the Company closed a private placement offering (the "2007 Offering") of 1,675,000 units (a "Unit") at a price of \$0.40 per Unit, for aggregate gross proceeds to the Company of \$670,000. Each Unit is comprised of one common share (a "Share") and one half of one Share purchase warrant (a "Warrant"). Each whole Warrant entitled the holder to purchase one Share at a price of \$0.60 at any time within eighteen months of the closing date of the 2007 Offering. The Warrants expired subsequent to year-end on February 16, 2009. The fair value assigned to the Warrants upon issuance was \$61,563.

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**8. Capital stock (continued):****(b) Shares issued and outstanding (continued):**

Certain individuals and companies assisted the Company by introducing potential subscribers for the 2007 Offering and received a finder's fee of eight percent of the total subscription proceeds received from subscribers introduced to the Company by each particular individual and company. In addition, these individuals and companies were issued 115,500 compensation warrants (a "Compensation Warrant"), equivalent to seven percent of the Units subscribed for by subscribers introduced to the Company by each particular individual and company. Each Compensation Warrant entitles the holder to purchase one Share at a price of \$0.50 per Share within one year of the closing date of the 2007 Offering. The Compensation Warrants expired on August 16, 2008. The fair value of \$8,575 assigned to the Compensation Warrants upon issuance is included in share issue costs.

- (2) On February 28, 2008, the Company closed a private placement offering (the "2008 Offering") of 6,200,000 units (a "Unit") at a price of \$0.25 per share, for aggregate gross proceeds to the Company of \$1,550,000. Each Unit was comprised of one common share (a "Share") and one half of one share purchase warrant (a "Warrant"). Each whole Warrant entitled the holder to purchase one Share at a price of \$0.40 per Share at any time within eighteen months of the closing date of the 2008 Offering. The Warrants will expire on August 28, 2009. The fair value assigned to the Warrants upon issuance was \$616,829.

Certain individuals and companies assisted the Company by introducing potential subscribers for the 2008 Offering and received a finder's fee in the amount of \$100,300 calculated as eight percent of the total subscription proceeds received from subscribers introduced to the Company by each particular individual and company. In addition, these individuals and companies were issued 278,600 compensation warrants (a "Compensation Warrant"), equivalent to seven percent of the units subscribed for by subscribers introduced to the Company by each particular individual and company. Each Compensation Warrant entitles the holder to purchase one Share at a price of \$0.28 per Share within one year of the closing date of the 2008 Offering. The Compensation Warrants expired subsequent to year-end on February 28, 2009. The fair value of \$57,290 assigned to the Compensation Warrants upon issuance is included in share issue costs.

**(c) Options:**

The Company has a stock option plan which is administered by the Board of Directors of the Company with stock options granted to directors, management, employees, management company employees and consultants as a form of compensation. The number of common shares reserved for issuance of stock options is limited to a maximum of 10% of the issued and outstanding shares of the Company at any one time.

# KANE BIOTECH INC.

Notes to the Financial Statements  
Years ended December 31, 2008 and 2007

## 8. Capital stock (continued):

### (c) Options (continued):

Changes in the number of options outstanding during the year ended December 31, 2008 are as follows:

	December 31, 2008		December 31, 2007	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Balance, beginning of year	1,657,211	\$ 0.42	1,100,875	\$ 0.41
Granted	-	-	625,000	0.42
Exercised	-	-	(54,164)	0.30
Forfeited, cancelled or expired	(399,711)	0.36	(14,500)	0.35
Balance, end of year	1,257,500	0.44	1,657,211	0.42
Options exercisable, end of year	1,257,500		1,649,711	
Weighted average fair value per unit of option granted during the year		\$ -		\$ 0.30

Options outstanding at December 31, 2008 consist of the following:

Range of exercise prices	Outstanding number	Weighted average remaining contractual life	Weighted average exercise price	Exercisable number
\$0.35 - \$0.55	1,257,500	2.50 years	\$0.44	1,257,500

For the year ended December 31, 2008, compensation expense of \$454 (2007 - \$185,229) was recorded as an adjustment due to change in fair value of options previously granted, but not fully vested.

The compensation expense was determined based on the fair value of the options at the date of measurement using the Black-Scholes option pricing model with the following weighted average assumptions:

	December 31, 2008	December 31, 2007
Expected option life	5.0 years	5.0 years
Risk free interest rate	3.40%	3.15%
Dividend yield	nil	nil
Expected volatility	91.02%	79.76%

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 8. Capital stock (continued):

#### (c) Options (continued):

The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the measurement date is measured and recognized at that date. For awards that vest at the end of a vesting period, compensation cost is recognized on a straight-line basis over the period of service. The Company recognizes the effect of forfeitures on unvested options as they occur.

#### (d) Warrants:

Changes in the number of warrants outstanding during the year ended December 31, 2008 are as follows:

	December 31, 2008			December 31, 2007		
	Shares	Amount	Weighted average exercise price	Shares	Amount	Weighted average exercise price
Balance, beginning of year	953,000	\$ 70,138	\$ 0.59	1,525,418	\$ 194,338	\$ 0.68
Granted, pursuant to private placements (Note 8(b))	3,100,000	616,829	0.40	837,500	61,563	0.60
Granted (Note 8(b))	278,600	57,290	0.28	115,500	8,575	0.50
Expired (Note 8(e))	(115,500)	(8,575)	0.50	(1,525,418)	(194,338)	0.68
Balance, end of year	4,216,100	\$ 735,682	0.43	953,000	\$ 70,138	0.59
Weighted average remaining contractual life (years)			0.52 years			1.07 years

In 2008, the Company granted 3,100,000 Warrants together with common shares under the Offering (Note 8(b)), entitling the holders to purchase one common share at a price of \$0.40 for a period of eighteen months commencing from the closing of the Offering. Net proceeds were allocated to common shares and warrants based on their relative fair values using the Black-Scholes model. These warrants will expire on August 28, 2009.

The Company granted 278,600 Compensation Warrants relating to the Offering (Note 8(b)), entitling the holders to purchase one common share at a price of \$0.28 for a period of one year commencing from the closing of the Offering. Share issue costs of \$57,290 were recorded in the 2008 fiscal year to reflect the value of these warrants. These warrants expired subsequent to year-end on February 28, 2009.

The fair value of warrants was determined at the date of measurement using the Black Scholes option pricing model with the following weighted average assumptions:

	December 31, 2008	December 31, 2007
Expected life	1.5 years	1.4 years
Risk free interest rate	2.97%	4.33%
Dividend yield	nil	nil
Expected volatility	106.13%	90.73%

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### (e) Contributed surplus:

Changes in contributed surplus are as follows:

	December 31, 2008	December 31, 2007
Balance, beginning of year	\$ 614,148	\$ 234,581
Stock-based compensation	454	185,229
Expired warrants (Note 8(d))	8,575	194,338
Balance, end of period	\$ 623,177	\$ 614,148

### (f) Escrowed shares:

The Company's issued share capital includes 1,275,000 (2007 - 2,550,000) shares which are currently in escrow and will be released for trading in two installments of 637,500 each. The initial release of shares from escrow was September 30, 2003 and all shares will be released by September 30, 2009.

### (g) Per share amounts:

The weighted average number of common shares outstanding for the year ended December 31, 2008 and 2007 was 24,229,037 and 17,959,930, respectively. The dilution created by options and warrants has not been reflected in the per share amounts as the effect would be anti-dilutive.

## 9. Income taxes:

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

	2008	2007
Future tax assets:		
Non-capital loss carry-forwards	\$ 1,120,429	\$ 998,243
Scientific research and experimental development	208,606	168,627
Share issue costs	50,166	39,608
Property and equipment	(8,017)	(8,457)
Patents	(76,083)	(59,253)
Other	252	291
	1,295,353	1,139,059
less: Valuation allowance	(1,295,353)	(1,139,059)
	\$ -	\$ -

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 9. Income taxes (continued):

The reconciliation of the Canadian statutory rate to the income tax provision is as follows:

	2008	2007
Canadian federal and provincial income taxes at 33.00% (2007 - 36.12%)	\$ (355,359)	\$ (393,692)
Change in rates	81,361	164,818
Rate difference between current and future taxes	75,255	73,367
Permanent differences and other items	42,449	104,248
Change in valuation allowance	156,294	51,259
	\$ -	\$ -

At December 31, 2008, the Company has the following available for application in future years:

- Unutilized Canadian non-capital loss carried forward balances for income tax purposes of \$4,310,000 (2007 - \$3,565,000), with expiry dates ranging from 2009 to 2028;
- Unutilized scientific research and development expenditures of \$802,000 (2007 - \$602,000), with no expiry;
- Scientific research and development tax credits of \$414,000 (2007 - \$260,000), which can be applied against income taxes otherwise payable, with expiry by 2027.

### 10. Commitments and contingencies:

#### (a) Commitments:

As at December 31, 2008 and in the normal course of business, the Company has obligations to make future payments, representing contracts and other commitments that are known and committed.

Contractual obligation payments due by fiscal period ending December 31:

2009	\$ 37,752
2010	16,938
2011	10,000
2012	10,000
2013	10,000
	\$ 84,690

The annual lease payments are exclusive of maintenance, property taxes, insurance and other operating costs. The premises are leased from a company controlled by a director.

**KANE BIOTECH INC.****Notes to the Financial Statements**Years ended December 31, 2008 and 2007

---

**10. Commitments and contingencies (continued):****(a) Commitments (continued):**

The Company has a business and administration services agreement with Genesys Venture Inc (Note 11). The Company is committed to pay \$160,000 per annum. The agreement shall be automatically renewed for succeeding terms of one year on terms to be mutually agreed upon by the parties. The Company may terminate this agreement at any time upon 90 days written notice.

**(b) Guarantees:**

The Company periodically enters into research and licence agreements with third parties that include indemnification provisions customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of claims arising from research and development activities undertaken on behalf of the Company. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions could be unlimited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in the accompanying financial statements with respect to these indemnification obligations.

**11. Related party transactions:**

During the year ended December 31, 2008, the Company paid Genesys Venture Inc., a company controlled by a director, a total of \$160,000 (2007 - \$160,000) for consulting fees in accordance with the above noted contractual obligation and \$27,750 (2007 - \$30,987) under a sub-lease rental agreement in accordance with the above noted contractual obligation. During the same period, the Company also paid a company controlled by an officer \$2,500 (2007 - \$3,000) for rental of equipment.

As of December 31, 2008, included in accounts payable and accrued liabilities is \$2,577 (2007 - \$3,877) owed to Genesys Venture Inc. The Company has provided a non-interest bearing advance of \$5,800 (2007 - \$5,800) to Genesys Venture Inc. used for payroll processing, which is included in prepaid expenses.

During the year ended December 31, 2008, the Company paid nil (2007 - \$2,389) in consulting fees to a shareholder of the Company.

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

**12. Government assistance:**

During the year ended December 31, 2008, the Company received \$315,362 (2007 - \$7,500) in government assistance for the purpose of research. The funding has been recorded against the related research expenditures.

## KANE BIOTECH INC.

### Notes to the Financial Statements

Years ended December 31, 2008 and 2007

---

#### 13. Capital risk management:

The Company's objectives when managing capital are:

- To safeguard the Company's ability to continue as a going concern in order to pursue the development of its products and to maintain a flexible capital structure which optimizes the cost of capital at an acceptable level; and
- To provide an adequate return to shareholders commensurate with the level of risk associated with a development stage biotechnology company.

The capital structure of the Company consists of equity comprising issued capital, contributed surplus, and warrants.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues, granting of stock options, the issue of debt or by undertaking other activities as deemed appropriate under the specific circumstances. The Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2007.

The Company is not subject to externally imposed capital requirements. In order to maximize ongoing research and development of its products, the Company does not pay out dividends.

#### 14. Financial risk management:

The Company has exposure to credit risk, liquidity risk and market risk. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The audit committee of the board is responsible to review the Company's risk management policies.

##### (a) Credit Risk:

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's accounts receivable and cash and cash equivalents. The carrying amount of financial assets represents the maximum credit exposure.

The Company has investment policies to mitigate against the deterioration of principal and to enhance the Company's ability to meet its liquidity needs. Cash and cash equivalents are on deposit with a credit union and guaranteed by the Credit Union Deposit Guarantee Corporation of Manitoba.

##### (b) Liquidity Risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due and to fund future operations. The Company manages its liquidity risk by forecasting its cash needs on a regular basis and seeking additional financing based on those forecasts.

As at December 31, 2008, the Company had financial assets held-for-trading of \$548,983 (December 31, 2007 - \$344,511), loans and receivables of \$101,260 (December 31, 2007 - \$36,352) and other financial liabilities of \$79,562 (December 31, 2007 - \$87,858). All of the Company's financial liabilities have contracted maturities of less than one year.

# KANE BIOTECH INC.

## Notes to the Financial Statements

Years ended December 31, 2008 and 2007

### 14. Financial risk management (continued):

#### (c) Market Risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its financial instruments.

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates primarily within Canada although a portion of its expenses are incurred in United States dollars ("US dollar"). The Company has not entered into foreign exchange derivative contracts. A significant change in the currency exchange rates between the Canadian dollar relative to the US dollar could have an effect on the Company's results of operations, financial position and cash flows.

As at December 31, 2008, the Company is exposed to currency risk through its cash and cash equivalents and accounts payable denominated in US dollars as follows:

	December 31, 2008	December 31, 2007
Cash and cash equivalents	\$ 1,728	\$ -
Accounts receivable	5,240	-
Accounts payable	(6,726)	(11,928)
Net	\$ 242	\$ (11,928)

Based on the above net exposures as at December 31, 2008, and assuming that all other variables remain constant, a 5% appreciation or deterioration of the Canadian dollar against the US dollar would not be significant.

The Company is subject to interest rate risk on its cash and cash equivalents. The Company believes that interest rate risk is low as the Company does not hold any term deposits and interest earned on cash equivalents is variable. A change of 1% in interest rates over the year ended December 31, 2008 would not have been significant.

### 15. Subsequent event:

On March 30, 2009, the Company announced a non-brokered private placement offering for gross proceeds of up to \$250,000 consisting of up to 3,571,428 units at a price of \$0.07 per unit. Each unit will be comprised of one common share of the Company and one half of one share purchase warrant. Each whole warrant will expire 18 months from the date the warrant is issued and will entitle the holder to purchase one share at a price of \$0.10 per share if purchased within 6 months from the date the warrant is issued or \$0.15 per share if purchased after 6 months up to the expiry date of the warrant. The net proceeds of the offering, if any, shall be used for research and development and working capital purposes.