KANE BIOTECH INC.
FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

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KANE BIOTECH

MANAGEMENT REPORT

The accompanying financial statements have been prepared by management and approved by the board of directors of Kane Biotech Inc. (the "Company"). Management is responsible for the information and representations contained in these financial statements.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies, which management believes are appropriate for the Company, are described in note 2 to these financial statements. The Company maintains a system of internal control and appropriate processes to provide reasonable assurance that assets are safeguarded and to ensure that relevant and reliable financial information is produced.

The board of directors is responsible for reviewing and approving these financial statements and overseeing management's performance of its financial reporting responsibilities. An audit committee of three non-management directors is appointed by the board. The audit committee reviews the financial statements, audit process and financial reporting with management and with the external auditors and reports to the board of directors prior to the approval of the audited financial statements for publication.

KPMG LLP, the Company's external auditors, who are appointed by the shareholders, audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on these financial statements. Their report follows.

/s/ Gord Froehlich

Mr. Gord Froehlich
President & Chief Executive Officer

/s/ Eric Johnstone

Mr. Eric R. Johnstone, CA
Chief Financial Officer

April 26, 2010

KPMG LLP
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AUDITORS' REPORT

To the Shareholders of Kane Biotech Inc.

We have audited the balance sheets of Kane Biotech Inc. as at December 31, 2009 and 2008 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, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Winnipeg, Canada

April 26, 2010

KANE BIOTECH INC.

Balance Sheets
December 31, 2009 and 2008

	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	$ 804,919	$ 548,983
Accounts receivable	104,373	101,260
Prepaid expenses	11,331	43,800
	920,623	694,043
Property and equipment (Note 6)	44,536	71,108
Intangible assets (Note 7)	900,778	807,160
	$ 1,865,937	**$ 1,572,311**
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities (Note 11)	$ 68,618	$ 79,562
Shareholders' equity:		
Capital stock (Note 8(b))	6,792,616	5,548,574
Warrants (Note 8(d))	311,794	735,682
Contributed surplus (Note 8(e))	984,840	623,177
Deficit	(6,291,931)	(5,414,684)
	1,797,319	1,492,749
Nature and continuation of operations - going concern (Note 1)		
Commitments and contingencies (Note 10)		
	$ 1,865,937	**$ 1,572,311**

On behalf of the Board:

/s/ Albert Friesen

Dr. Albert D. Friesen
Director

/s/ Peter de Visser

Mr. Peter de Visser, CA
Director

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

KANE BIOTECH INC.

Statements of Operations and Deficit
Years ended December 31, 2009 and 2008

		2009		2008
Expenses				
General and administration (Note 11)		463,507		487,228
Research (Notes 11 and 12)		325,813		520,304
Amortization		39,492		42,285
Write-down of patents (Note 7)		13,537		53,220
Stock-based compensation				
General and administration		27,250		454
Research		14,295		-
Loss before the undernoted		(883,894)		(1,103,491)
Other				
Investment income		6,647		26,647
Loss and comprehensive loss for the year		(877,247)		(1,076,844)
Deficit, beginning of year		(5,414,684)		(4,337,840)
Deficit, end of year	**$**	**(6,291,931)**	**$**	**(5,414,684)**
Basic and diluted loss per share (Note 8(g))	**$**	**(0.03)**	**$**	**(0.04)**

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

KANE BIOTECH INC.

Statements of Cash Flows
Years ended December 31, 2009 and 2008

	2009	2008
Cash provided by (used in):		
Operating activities:		
Loss and comprehensive loss for the year	$ (877,247)	$ (1,076,844)
Adjustments for:		
Amortization of property and equipment	27,390	30,089
Amortization of patents	12,102	12,196
Write-down of patents	13,537	53,220
Stock-based compensation	41,545	454
Change in the following:		
Accounts receivable	(3,113)	(64,908)
Prepaid expenses	32,469	(19,311)
Accounts payable and accrued liabilities	(10,944)	(8,296)
	(764,261)	(1,073,400)
Financing activities:		
Issuance of common shares, net of issue costs	1,140,272	1,428,405
Investing activities:		
Purchase of property and equipment, net of proceeds on disposal	(818)	-
Patent and trademark costs	(119,257)	(150,533)
	(120,075)	(150,533)
Increase in cash	255,936	204,472
Cash and cash equivalents, beginning of year	548,983	344,511
Cash and cash equivalents, end of year	**$ 804,919**	**$ 548,983**

Supplemental cash flow information:

	2009	2008
Non-cash financing activities:		
Warrants issued as share issue costs	$ 27,422	$ 57,290

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

1. Nature and continuation of operations - going concern:

Kane Biotech Inc. (the "Company") is a biotechnology company engaged in the development of products to prevent and remove microbial 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, 2009, the Company has expended approximately $2,734,321, net of government assistance, on research.

These financial statements have been prepared using 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 and commitments in the normal course of business. There is substantial doubt about the appropriateness of the use of the going concern assumption because the Company has experienced operating losses and cash outflows from operations since incorporation and has not reached successful commercialization of its products.

The Company's future operations are 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 these plans, there is no assurance that these and other strategies will be achieved or such sources of funds will be available or obtained on favourable terms or obtained at all. If the Company cannot generate product sales, negotiate collaboration or licence agreements with upfront payments, obtain research grant funding, or if it cannot secure additional financing on terms that would be acceptable to it, the Company will have to consider additional strategic alternatives which may include, among other strategies, exploring the monetization of certain intangible assets as well as seeking to outlicense assets or potential asset divestitures.

The ability of the Company to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities and commitments when due is dependent on the successful completion of the actions taken or planned, some of which are described above, which management believes will mitigate the adverse conditions and events which raise doubt about the validity of the going concern assumption used in preparing these financial statements. There is no certainty that these and other strategies will be sufficient to permit the Company to continue as a going concern.

These financial statements do not reflect adjustments in the carrying values of the Company's assets and liabilities, expenses, and the balance sheet classification used, that would be necessary if the going concern assumption were not appropriate. Such adjustments 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.

2. Significant accounting policies (continued):

(b) General Standards of Financial Statement Presentation:

In accordance with Handbook Section 1400 "General Standards of Financial Statement Presentation", management assesses the ability of the Company to continue as a going concern. Management periodically makes 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 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 is disclosed in Note 1.

(c) 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

(d) Patents and trademarks:

Costs incurred in successfully obtaining a patent or trademark 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.

(e) Technology licenses:

Technology licenses are recorded at cost. The cost of technology licenses will be amortized over their estimated useful life commencing in the period in which the product is commercially launched and sales of the licensed product are first earned.

(f) 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. In addition, technology licences are subject to an annual impairment test until commercialization of the related licensed product. 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.

2. Significant accounting policies (continued):

(g) 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.

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 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, 2009 and no opening or closing balances for accumulated other comprehensive income or loss.

(h) 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.

2. Significant accounting policies (continued):

(i) 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.

(j) 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.

(k) 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.

(l) 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.

(m) Foreign currency translation:

Monetary assets and liabilities denominated in foreign currencies are translated at the prevailing rates of exchange at the balance sheet dates. Expenses are translated at the exchange rates prevailing on the transaction date. Realized and unrealized exchange gains and losses are included in income.

2. Significant accounting policies (continued):

(n) 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 and development costs, stock-based compensation, and valuation of intangible assets. Actual results could differ from those estimates.

3. New Accounting Standards adopted during the year:

The Company adopted the following CICA Handbook standard: Section 3064 "Goodwill and Intangible Assets" on January 1, 2009.

(a) Goodwill and intangible assets:

The Company adopted CICA Handbook Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research & Development Costs, and 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 International Accounting Standard 38, Intangible Assets. There was no impact on the Company's financial position and results of operations on adoption of this standard.

4. 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 confirmed 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 change over 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.

5. Financial instruments:

The Company has classified its financial instruments as follows:

	December 31, 2009	December 31, 2008
Financial assets:		
Cash and cash equivalents (Held-for-trading)	$ 804,919	$ 548,983
Accounts receivable (Loans and receivables)	104,373	101,260
	$ 909,292	$ 650,243
Financial liabilities:		
Accounts payable and accrued liabilities (Other financial liabilities)	$ 68,618	$ 79,562

The Company had neither available-for-sale nor held-to-maturity financial instruments during the year ended December 31, 2009 or the year ended December 31, 2008. 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, 2009	Cost	Accumulated amortization	Net book value
Computer and office equipment	$ 13,015	$ 9,359	$ 3,656
Scientific equipment	126,321	87,776	38,545
Leasehold improvements	82,789	80,454	2,335
	$ 222,125	$ 177,589	$ 44,536

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
	$ 221,309	$ 150,201	$ 71,108

7. Intangible assets:

December 31, 2009		Cost, net of impairments		Accumulated amortization		Net book value
Patents [1]	$	618,890	$	32,423	$	586,467
Trademarks		16,161		-		16,161
Technology licenses [2]		298,150		-		298,150
	$	933,201	$	32,423	$	900,778

December 31, 2008		Cost, net of impairments		Accumulated amortization		Net book value
Patents [1]	$	518,556	$	20,322	$	498,234
Trademarks		10,776		-		10,776
Technology licenses [2]		298,150		-		298,150
	$	827,482	$	20,322	$	807,160

(1) During the year ended December 31, 2009 the Company recorded a write-down of patents equal to $13,537 (December 31, 2008 - $53,220) as part of the ongoing review of the portfolio of intellectual property. The write-down recognized certain applications no longer being pursued and consequently determined to have no future value.

(2) 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 sub-license fees. 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, 2009.

7. Intangible assets (continued):

On April 1, 2005, the Company acquired the worldwide exclusive license to all human and industrial applications of the DispersinB® 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. There were no sales of licensed products to December 31, 2009.

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, 2007	19,028,491	$ 4,794,288
Issued for cash, net of issue costs of $178,885 (1)	6,200,000	754,286
Balance, December 31, 2008	25,228,491	5,548,574
Issued for cash, net of issue costs of $31,063 (2)	3,571,429	111,591
Issued for cash, net of issue costs of $81,764 (3)	4,335,500	297,809
Early exercise warrant incentive program, net of costs of $13,153 (4)	2,088,500	554,680
Exercise of warrants	1,730,165	279,962
Balance, December 31, 2009	36,954,085	$ 6,792,616

(1) 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 expired on September 18, 2009 . The fair value assigned to the Warrants upon issuance was $616,829.

8. Capital stock (continued):

(b) Shares issued and outstanding (continued):

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 entitled 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 on February 28, 2009. The fair value of $57,290 assigned to the Compensation Warrants upon issuance is included in share issue costs.

(2) On May 14, 2009, the Company closed a private placement offering (the "Q2 2009 Offering") of 3,571,429 units (a "Unit") at a price of $0.07 per share, for aggregate gross proceeds to the Company of $250,000. Each Unit was comprised of one Share and one half of one Warrant. Each whole Warrant entitled the holder to purchase one Share at a price of $0.10 per Share if exercised within six months from the date the Warrant is issued or $0.15 per Share if exercised after six month up to eighteen months from the closing date of the Q2 2009 Offering. The Warrants will expire on November 14, 2010. The fair value assigned to the Warrants upon issuance was $107,346.

Certain individuals and companies assisted the Company by introducing potential subscribers for the Q2 2009 Offering and received a finder's fee in the amount of $12,350 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 117,936 Compensation Warrants, equivalent to seven percent of the units subscribed for by subscribers introduced to the Company by each particular individual and company. Each Compensation Warrant entitled the holder to purchase one Share at a price of $0.07 per Share within one year of the closing date of the Q2 2009 Offering. The fair value of $6,492 assigned to the Compensation Warrants upon issuance is included in share issue costs of $31,063.

(3) On December 1, 2009, the Company closed a private placement offering (the "Q4 2009 Offering") of 4,335,500 units (a "Unit") at a price of $0.13 per share, for aggregate gross proceeds to the Company of $563,615. Each Unit was comprised of one Share and one half of one Warrant. Each whole Warrant entitled the holder to purchase one Share at a price of $0.17 per Share if exercised within six months from the date the Warrant is issued or $0.25 per Share if exercised after six month up to eighteen months from the closing date of the Q4 2009 Offering. The Warrants will expire on June 1, 2011. The fair value assigned to the Warrants upon issuance was $184,042.

Certain individuals and companies assisted the Company by introducing potential subscribers for the Q4 2009 Offering and received a finder's fee in the amount of $44,975 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 244,980 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 entitled the holder to purchase one Share at a price of $0.14 per Share within one year of the closing date of the Q4 2009 Offering. The fair value of $20,930 assigned to the Compensation Warrants upon issuance is included in share issue costs of $81,764.

8. Capital stock (continued):

(b) Shares issued and outstanding (continued):

(4) On August 6, 2009, the Company announced an early exercise warrant incentive program ("Warrant Incentive Program") under which existing holders of certain common share purchase warrants exercised an aggregate of 2,088,500 warrants at a price of $0.12 per unit for gross proceeds to the Company of $250,620. Existing warrant holders who exercised under the Warrant Incentive Program received one unit for each warrant exercised. Each unit was comprised of one common share and one half of one share purchase warrant (an "Incentive Warrant"). Each whole Incentive Warrant entitles the holder to purchase one Common Share at a price of $0.14 per Share if exercised within six months from the date the Incentive Warrant is issued or $0.22 per Share if exercised after six months up to eighteen months from the closing date of the Warrant Incentive Program. The Incentive Warrants will expire on March 28, 2011 and the fair value assigned upon issuance was $98,350. Under the Warrant Incentive Program, warrants previously issued with a fair value of $415,563 were exercised and accordingly were transferred from warrants to capital stock (Note 8(d)).

(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.

Changes in the number of options outstanding during the year ended December 31, 2009 and 2008 are as follows:

	December 31, 2009		December 31, 2008	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Balance, beginning of year	1,257,500	$ 0.44	1,657,211	$ 0.42
Granted	465,000	0.15	-	-
Forfeited, cancelled or expired	(290,000)	0.44	(399,711)	0.36
Balance, end of year	1,432,500	$ 0.35	1,257,500	$ 0.44
Options exercisable, end of year	1,432,500		1,257,500	
Weighted average fair value per unit of option granted during the year		$ 0.09		$ -

8. Capital stock (continued):

(c) Options (continued):

Options outstanding at December 31, 2009 consist of the following:

Range of exercise prices	Outstanding number	Weighted average remaining contractual life	Weighted average exercise price	Exercisable number
\$0.15 - \$0.56	1,432,500	2.75 years	\$0.35	1,432,500

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, 2009	December 31, 2008
Expected option life	5.0 years	5.0 years
Risk free interest rate	2.48%	3.40%
Dividend yield	nil	nil
Expected volatility	122.35%	91.02%

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.

In January 2010, the Company issued 175,000 stock options to the President and Chief Executive Officer of the Company with an exercise price of \$0.15.

(d) Warrants:

Changes in the number of warrants outstanding during the year ended December 31, 2009 and 2008 are as follows:

	December 31, 2009			December 31, 2008		
	Shares	Amount	Weighted average exercise price	Shares	Amount	Weighted average exercise price
Balance, beginning of year	4,216,100	\$ 735,682	\$ 0.43	953,000	\$ 70,138	\$ 0.59
Granted, pursuant to private placements (Note 8(b))	3,953,464	291,388	0.17	3,100,000	616,829	0.40
Granted (Note 8(b))	362,916	27,422	0.12	278,600	57,290	0.28
Granted, pursuant to warrant exercise (Note 8(b))	1,044,250	98,350	0.14	-	-	-
Early exercise incentive program (Note 8(b))	(2,088,500)	(415,563)	0.40	-	-	-
Exercised (Note 8(b))	(1,730,165)	(105,367)	0.10	-	-	-
Expired (Note 8(e))	(2,127,600)	(320,118)	0.46	(115,500)	(8,575)	0.50
Balance, end of year	3,630,465	\$ 311,794	\$ 0.19	4,216,100	\$ 735,682	\$ 0.43

8. Capital stock (continued):

(d) Warrants (continued):

	December 31, 2009	December 31, 2008
Weighted average remaining contractual life (years)	1.28 years	0.52 years

In 2008, the Company granted 3,100,000 Warrants together with common shares under the 2008 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 2008 Offering. Net proceeds were allocated to common shares and warrants based on their relative fair values using the Black-Scholes model. On August 6, 2009, the Company announced an amendment to the terms of 3,100,000 Warrants issued under the 2008 Offering, in connection with an early warrant incentive program (Note 8(d)).

The Company granted 278,600 Compensation Warrants relating to the 2008 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 2008 Offering. Share issue costs of $57,290 were recorded in the 2008 fiscal year to reflect the value of these warrants. These warrants expired February 28, 2009.

In 2009, the Company granted 1,785,714 Warrants together with common shares under the Q2 2009 Offering (Note 8(b)). Each whole Warrant entitles the holder to purchase one Share at a price of $0.10 per Share if exercised within six months from the date the Warrant was issued or $0.15 per Share if exercised after six month up to eighteen months from the closing date of the Q2 2009 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 November 14, 2010.

The Company granted 117,936 Compensation Warrants relating to the Q2 2009 Offering (Note 8(b)), entitling the holders to purchase one common share at a price of $0.07 for a period of one year commencing from the closing of the Q2 2009 Offering. Share issue costs of $6,492 were recorded in the 2009 fiscal year to reflect the value of these warrants. These warrants will expire May 14, 2010.

In 2009, the Company granted 2,167,750 Warrants together with common shares under the Q4 2009 Offering (Note 8(b)). Each whole Warrant entitles the holder to purchase one Share at a price of $0.17 per Share if exercised within six months from the date the Warrant was issued or $0.25 per Share if exercised after six month up to eighteen months from the closing date of the Q4 2009 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 June 1, 2011.

The Company granted 244,980 Compensation Warrants relating to the Q4 2009 Offering (Note 8(b)), entitling the holders to purchase one common share at a price of $0.14 for a period of one year commencing from the closing of the Q4 2009 Offering. Share issue costs of $20,930 were recorded in the 2009 fiscal year to reflect the value of these warrants. These warrants will expire December 1, 2010.

In 2009, the Company granted 1,044,250 Warrants together with common shares under the Warrant Incentive Program (Note 8(b)), each whole Warrant entitles the holder to purchase one Share at a price of $0.14 per Share if exercised within six months from the date the Warrant is issued or $0.22 per Share if exercised after six month up to eighteen months of the closing date of the Warrant Incentive Program. Net proceeds were allocated to common shares and warrants based on their relative fair values using the Black-Scholes model. These warrants will expire March 28, 2011.

8. Capital stock (continued):

(d) Warrants (continued):

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, 2009	December 31, 2008
Expected life	1.5 years	1.5 years
Risk free interest rate	1.05%	2.97%
Dividend yield	nil	nil
Expected volatility	194.89%	106.13%

(e) Contributed surplus:

Changes in contributed surplus are as follows:

	December 31, 2009	December 31, 2008
Balance, beginning of year	$ 623,177	$ 614,148
Stock-based compensation	41,545	454
Expired warrants (Note 8(d))	320,118	8,575
Balance, end of year	$ 984,840	$ 623,177

(f) Escrowed shares:

The Company's issued share capital includes no shares in escrow (December 31, 2008 - 1,275,000). The initial release of shares from escrow was September 30, 2003 and the final installment was released for trading on September 30, 2009.

(g) Per share amounts:

The weighted average number of common shares outstanding for the year ended December 31, 2009 and 2008 was 28,636,953 and 24,229,037, 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:

	2009	2008
Future tax assets:		
Non-capital loss carry-forwards	$ 1,350,927	$ 1,120,429
Scientific research and experimental development	231,650	208,606
Share issue costs	53,345	50,166
Property and equipment	(5,353)	(8,017)
Intangible assets	(106,737)	(76,083)
Other	235	252
	1,524,067	1,295,353
less: Valuation allowance	(1,524,067)	(1,295,353)
	$ -	$ -

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

	2009	2008
Canadian federal and provincial income taxes at 31.50% (2008 - 33.00%)	$ (276,333)	$ (355,359)
Change in rates	-	81,361
Rate difference between current and future taxes	45,917	75,255
Permanent differences and other items	1,702	42,449
Change in valuation allowance	228,714	156,294
	$ -	$ -

At December 31, 2009, the Company has the following available for application in future years:

- Unutilized Canadian non-capital loss carried forward balances for income tax purposes of $5,196,000 (2008 - $4,310,000), with expiry dates ranging from 2010 to 2029;
- Unutilized scientific research and development expenditures of $891,000 (2008 - $802,000), with no expiry;
- Scientific research and development tax credits of $485,000 (2008 - $414,000), which can be applied against income taxes otherwise payable, with expiry by 2027.

10. Commitments and contingencies:

(a) Commitments:

As at December 31, 2009 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:

2010	$	16,938
2011		10,000
2012		10,000
2013		10,000
2014		10,000
	$	56,938

Included in the above noted obligations are annual lease payments which are exclusive of maintenance, property taxes, insurance and other operating costs. The premises are leased from Genesys Venture Inc. ("GVI"), a company controlled by a director.

The Company also has a business and administration services agreement with GVI (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 license 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:

Related parties consist of certain officers and shareholders, and companies with significant influence. 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.

During the year ended December 31, 2009, the Company paid GVI a total of $160,000 (December 31, 2008 - $160,000) for consulting fees in accordance with the above noted contractual obligation and $27,750 (December 31, 2008 - $27,750) under a sub-lease rental agreement in accordance with the above noted contractual obligation.

11. Related party transactions (continued):

As of December 31, 2009, included in accounts payable and accrued liabilities is $917 (December 31, 2008 - $2,577) owed to Genesys Venture Inc.

12. Government and other assistance:

During the year ended December 31, 2009, the Company received $187,736 (December 31, 2008 - $315,362) in government and other assistance for the purpose of research. The funding has been recorded against the related research expenditures.

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, 2008.

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.

14. Financial risk management (continued):

(a) Credit Risk (continued):

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, 2009, the Company had financial assets held-for-trading of $804,919 (December 31, 2008 - $548,983), loans and receivables of $104,373 (December 31, 2008 - $101,260) and other financial liabilities of $68,618 (December 31, 2008 - $79,562). All of the Company's financial liabilities have contracted maturities of less than one year.

(c) Market Risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices that 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, 2009, the Company is exposed to currency risk through its cash and cash equivalents and accounts payable denominated in US dollars as follows:

	December 31, 2009	December 31, 2008
Cash and cash indebtedness	$ 19,266	$ 1,728
Accounts receivable	23,495	5,240
Accounts payable	(22,701)	(6,726)
Net	$ 20,060	$ 242

Based on the above net exposures as at December 31, 2009, 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, 2009 would not have been significant.