Consolidated Financial Statements

Quest PharmaTech Inc.

January 31, 2010 and 2009

AUDITORS' REPORT

To the Shareholders of
Quest PharmaTech Inc.

We have audited the consolidated balance sheets of **Quest PharmaTech Inc.** as at January 31, 2010 and 2009 and the consolidated statements of operations, comprehensive loss 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 bass, 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Edmonton, Canada,
May 12, 2010.

Chartered Accountants

Quest PharmaTech Inc.

CONSOLIDATED BALANCE SHEETS
(see note 1 - going concern uncertainty)

As at January 31

	2010 $	2009 $
ASSETS		
Current		
Cash and cash equivalents	**31,752**	594,826
Accounts receivable	**104,672**	54,617
Marketable securities *[note 5]*	**47,872**	53,010
Prepaid expenses	**6,575**	37,860
	190,871	740,313
Property and equipment *[note 4]*	**177,880**	238,024
Intangible assets *[note 3]*	**140,000**	—
	508,751	978,337
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	**315,512**	202,912
Convertible debenture *[note 6]*	**500,000**	497,137
Current portion of deferred revenue *[note 13]*	**8,000**	258,000
	823,512	958,049
Deferred revenue *[note 13]*	**85,667**	93,667
	909,179	1,051,716
Commitments and contingencies *[note 9]*		
Shareholders' deficiency		
Share capital *[note 10]*	**24,058,875**	23,998,875
Equity portion of convertible debenture *[note 6]*	**60,000**	60,000
Shares to be issued *[note 3]*	**60,000**	—
Contributed surplus *[note 10]*	**1,674,365**	1,603,615
Deficit	**(26,253,668)**	(25,735,869)
	(400,428)	(73,379)
	508,751	978,337

See accompanying notes

On behalf of the Board:

(signed)	(signed)
Ragupathy ("Madi") Madiyalakan	Ian McConnan
Director	Director

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

Years ended January 31

	2010 $	2009 $
REVENUE		
License fees and market distribution rights *[note 7]*	**758,000**	2,008,000
EXPENSES		
General and administrative	**712,516**	754,954
Research and development, net *[note 17]*	**419,063**	1,445,180
Amortization	**87,815**	40,203
Bank charges and interest *[notes 6 and 16]*	**48,956**	63,587
	1,268,350	2,303,924
Loss before the undernoted	**(510,350)**	(295,924)
Other income (expenses)		
Interest income	**2,522**	20,159
Foreign exchange gain (loss)	**(4,833)**	29,503
Gain on sale of non-core assets *[note 5]*	**—**	168,048
Loss on write-down/disposal of property and equipment *[note 4]*	**—**	(12,128)
Loss on fair value adjustment of marketable securities *[note 5]*	**(5,138)**	(113,705)
	(7,449)	91,877
Net and comprehensive loss for the year	**(517,799)**	(204,047)
Deficit, beginning of year	**(25,735,869)**	(25,531,822)
Deficit, end of year	**(26,253,668)**	(25,735,869)
Basic and diluted loss per share	**$(0.01)**	$(0.00)

See accompanying notes

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended January 31

	2010 $	2009 $
CASH USED IN OPERATING ACTIVITIES		
Net loss for the year	**(517,799)**	(204,047)
Items that do not involve cash		
Interest accreted on convertible debenture *[note 6]*	**2,863**	17,137
Amortization	**87,815**	40,203
Stock-based compensation *[notes 10 and 12]*	**70,750**	20,500
Gain on sale of non-core assets *[note 5]*	**—**	(168,048)
Loss on write-down/disposal of property and equipment *[note 4]*	**—**	12,128
Loss on fair value adjustment of marketable securities *[note 5]*	**5,138**	113,705
Deferred revenue recognized in the year *[note 13]*	**(758,000)**	(2,008,000)
Cash received on deferred license fees *[note 7]*	**500,000**	1,500,000
Net change in non-cash working capital items *[note 16]*	**93,830**	138,006
	(515,403)	(538,416)
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Purchase of property and equipment	**(10,171)**	(215,060)
Purchase of intangible assets	**(37,500)**	—
Cash proceeds from sale of property and equipment and other assets	**—**	42,500
	(47,671)	(172,560)
Net decrease in cash and cash equivalents	**(563,074)**	(710,976)
Cash and cash equivalents, beginning of year	**594,826**	1,305,802
Cash and cash equivalents, end of year	**31,752**	594,826

See accompanying notes

Quest PharmaTech Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

January 31, 2010 and 2009

1. DESCRIPTION OF BUSINESS AND GOING CONCERN UNCERTAINTY

Description of business

Quest PharmaTech Inc. (the "Company") is incorporated under the Business Corporations Act (Alberta). The Company's principal business activity is the research and development of pharmaceutical products. The Company is publicly traded on the TSX Venture Exchange under the symbol "QPT".

Going concern uncertainty

The Company's consolidated financial statements have been prepared on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced significant operating losses and cash outflows from operations since its inception.

The Company's ability to continue as a going concern is uncertain and is dependent upon its ability to raise funds through the ongoing divestiture of non-core assets and to raise additional capital to successfully complete its research and development programs, commercialize its technologies and conduct clinical trials and receive regulatory approvals for its products. It is not possible at this time to predict the outcome of these matters. The Company's consolidated financial statements do not reflect any adjustments to the classifications and carrying values of assets and liabilities that may be required should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business.

2. SIGNIFICANT ACCOUNTING POLICIES

The Company's consolidated financial statements have been prepared following Canadian generally accepted accounting principles ("GAAP"). The measurement of certain assets and liabilities is dependent upon future events whose outcome will not be fully known until future periods. Therefore, the preparation of these consolidated financial statements requires the Company's management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results may vary from those estimated. The recoverable value of property and equipment of $177,880 and intangible assets of $140,000, as well as the period over which deferred revenue is recognized into income, are the more significant items which reflect estimates in these consolidated financial statements. Such estimates and assumptions have been made using careful judgments, which, in management's opinion, are within reasonable limits of materiality and conform to the significant accounting policies summarized below.

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries:

Sonolight Pharmaceuticals Corp. ("Sonolight")
Steroidogenesis Inhibitors Canada Inc. ("SI Canada")

All significant intercompany transactions and balances are eliminated in the preparation of these consolidated financial statements.

Cash equivalents

Cash equivalents include short-term liquid investments with maturities of less than 90 days. Such investments are carried at fair value.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Intangible assets

Intangible assets include proprietary rights, intellectual property and patent rights which have been acquired from third parties. Intangible assets are recorded at cost less accumulated amortization. Following acquisition, the Company evaluates the prospective commercialization of the acquired intangible assets. Depending on the results of the evaluation, the Company generally amortizes the assets over a period of three to five years.

Proprietary rights and intellectual property

The Company's management evaluates the recoverability of the carrying cost of proprietary rights and intellectual property when circumstances warrant a determination, based on the expected utilization of the underlying technology and an assessment as to whether estimated future net cash flows exceed the carrying value of the proprietary rights and intellectual property. When the carrying amount exceeds its recoverable amount, an impairment is recognized for the difference between fair value and the carrying value.

Patent rights

Patent rights are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis over a maximum period of five years from the time of acquisition. The Company's management evaluates the recoverability of the cost of such rights when circumstances warrant a determination, based on the expected utilization of the underlying technology and an assessment as to whether estimated future net cash flows exceed the carrying value of the patent rights. When the carrying amount exceeds its recoverable amount, an impairment is recognized for the difference between fair value and the carrying value.

Property and equipment

Property and equipment are recorded at cost net of government assistance and accumulated amortization. Amortization of property and equipment is calculated over the estimated useful life on a declining balance or straight-line basis at the following annual rates:

Computer equipment	Declining balance - 30%
Furniture and fixtures	Declining balance - 30%
Office equipment	Declining balance - 30%
Manufacturing and R&D equipment	Declining balance - 30%
Leasehold improvements	Straight-line - lease term

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Leases

Leases that transfer substantially all the risks and benefits of assets to the Company are accounted for as capital leases. Assets under capital leases are recorded at the inception of the lease together with the long-term obligation to reflect the purchase and financing thereof. As at January 31, 2010 and 2009, the Company had no capital leases. Rental payments under operating leases are expensed evenly over the lease term.

Convertible debenture

On issuance of the debenture convertible into common shares of the Company, the fair value of the holders' conversion option is reflected as a component of shareholders' deficiency. The Company's obligation to debenture holders for future interest and principal payments is reflected as a liability and accreted to its maturity value over the term of the debenture using the effective interest method. If the holders exercise their conversion option, common shares issued on conversion will be recorded at an amount equal to the aggregate carrying value of the liabilities and the conversion option is extinguished with no gain or loss recognized.

Revenue recognition

Revenues associated with non-refundable up-front fees for the licensing of technology and products under agreements which require the Company to perform future performance obligations are recognized over the period of the contract as the performance obligation is satisfied. The portion related to future periods is recorded as deferred revenue.

Research and development

Research and development expenses are expensed as incurred. Up-front and milestone payments made to third parties in connection with specified research and development projects are expensed as incurred.

Investment tax credits

Investment tax credits relating to qualifying scientific research and experimental development expenditures that are recoverable in the current year are accounted for as a reduction in research and development expenditures. Investment tax credits are recognized when the related expenditures are incurred and there is reasonable assurance of their realization.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates prevailing at year end. Revenue and expenses are translated at exchange rates in effect on the date of the transaction. Gains and losses arising from translation of assets and liabilities are included in income for the period.

Government assistance

Non-refundable government assistance towards current expenses is included in the determination of income for the period as a reduction of the expenses to which it relates. Amounts received for future expenditures are recorded as a current liability. Government assistance towards the acquisition of property and equipment is deducted from the cost of the related property and equipment.

Comprehensive income

Comprehensive income is the change in equity of an enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by shareholders and distributions to shareholders. Other comprehensive income comprises revenues, expenses, gains and losses that are recognized in comprehensive income but are excluded from net loss calculated in accordance with GAAP. The Company did not have other comprehensive income, and accordingly, total comprehensive loss and net loss are the same.

Financial instruments

All financial instruments are classified as either held-for-trading, available-for-sale financial assets, loans and receivables, investments held to maturity or other financial liabilities. Financial assets classified as held-for-trading and available-for-sale are measured on the consolidated balance sheets at fair value. Subsequent changes in the fair value of held-for-trading financial assets are recognized in net loss immediately. Changes in the fair value of financial assets available-for-sale are recorded in comprehensive income until the investment is derecognized or impaired, at which time amounts would be recorded in net loss. Other comprehensive income and its components, when presented, are included directly in shareholders' equity as accumulated other comprehensive income. Loans and receivables, investments held to maturity and other financial liabilities are measured on the consolidated balance sheets at amortized cost.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company has designated cash and cash equivalents and marketable securities as held-for-trading, accounts receivable as loans and receivables and accounts payable and accrued liabilities and the liability component of the convertible debenture as other financial liabilities. The Company has not recorded any financial instruments as available-for-sale or held to maturity investments.

For financial liabilities classified as other, transaction costs that are directly attributable to the issue of the financial liability are recorded as part of the fair value initially recognized for the financial instrument. These costs are expensed using the effective interest method and recorded in interest expense.

Impairment of long-lived assets

The Company assesses the carrying value of long-lived assets, including property and equipment, intangible assets and other assets subject to amortization, for potential impairment when circumstances warrant a determination. Factors that are considered and which could lead to an impairment include significant changes in the manner of use of the asset or the overall strategy of the business.

Impairment of non-monetary long-lived assets is recognized when the carrying amount of an asset exceeds its recoverable amount. The impairment amount recorded will be the difference between the fair value and the carrying value.

Stock-based compensation

The Company accounts for stock options granted to employees and non-employees using the fair value method. Fair value is calculated using the Black-Scholes option pricing model with the assumptions described in note 12 and is recognized over the vesting period of the options granted. Consideration paid on the exercise of stock options is credited to share capital and the amount in contributed surplus related to the stock options exercised is reclassified to share capital.

Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued or liabilities incurred, whichever is more reliably measured. The cost of stock-based payments to non-employees is recognized over the vesting period. For fully vested and non-forfeitable stock-based payments, the cost is measured and recognized at the grant date.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. Future tax assets for which the realization of any value is more likely than not to occur are recognized. A valuation allowance is recorded for that portion not more likely to occur. As at January 31, 2010 and 2009, the Company recognized a valuation allowance of $4,338,312 and $4,551,909, respectively.

Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed using the treasury-stock method. Under this method, options, warrants and convertible securities are assumed to be exercised at the beginning of the period (or at the time of issuance, if later). Proceeds from the exercise are assumed to be used to purchase common shares at the average market price during the period. Incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) are included in the denominator of the diluted loss per share computation.

Basic income (loss) per share has been calculated using the weighted-average number of common shares outstanding during the year (2010 – 68,758,757; 2009 – 68,179,580). For the periods presented, the calculation of loss per common share on a diluted basis excluded all potential common shares because the effect was anti-dilutive (note 10).

Changes in significant accounting policies

Accounting changes

Goodwill and Intangible Assets
In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 3064, Goodwill and Intangible Assets. This new standard, which is effective for fiscal periods beginning on or after January 1, 2009, establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company has adopted this section for its fiscal year beginning February 1, 2009. Adoption of this section did not have a material impact on the Company's consolidated financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Credit Risk and the Fair Value of Financial Assets and Financial Liabilities
In January 2009, the CICA issued EIC Abstract 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The EIC requires the Company to take into account the Company's own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC 173 is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in the interim and annual financial statements for the periods ending on or after the date of issuance of the Abstract. The Company has adopted this standard for its fiscal year beginning February 1, 2009. Adoption of this standard had no impact on its consolidated financial statements.

Financial Instruments - Disclosures
In March 2009, the Canadian Accounting Standards Board announced it has agreed to adopt recent amendments to IFRS 7, Financial Instruments: Disclosures, into Section 3862, Financial Instruments – Disclosures. The amendments to Section 3862 will apply to annual financial statements for years ending after September 30, 2009. The amendments require that an entity disclose the classification, for each class of financial instrument, of fair value measurements within a fair value hierarchy. The hierarchy includes three levels: Level 1 – quoted prices in active markets, Level 2 – measurements determined using valuation models that employ observable inputs and Level 3 – measurements determined using valuation models that employ unobservable inputs. The Company adopted this standard and has reflected the required changes to its disclosures in these consolidated financial statements.

Future accounting pronouncements

International Financial Reporting Standards
In February 2008, the Canadian Accounting Standards Board confirmed that Canadian public enterprises will need to adopt International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. The Company will be required to report its results in accordance with IFRS commencing in its fiscal year ending January 31, 2012. The Company has commenced its conversion project and is assessing the future impact of the transition to IFRS on its financial statements. With this the Company has developed a conversion plan, including a detailed timeline, identification of staff training and education requirements and the impact on the Company's accounting policies, information systems, internal controls and business operations. During the year ended January 31, 2010, Company staff attended IFRS training sessions and the Company completed a high level review of the key accounting policy differences between Canadian GAAP and IFRS as well as the policy choices and elections allowed under IFRS. The areas identified to have the highest potential to impact the Company are property and equipment, intangible assets and initial adoption of IFRS under the provisions of IFRS 1 "First

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Time Adoption of IFRS". The Company is now completing a detailed analysis and evaluation of options available under IFRS, the financial impact of those options, and the impact on internal controls over financial reporting is in progress. Policy choices are currently being reviewed and it is expected that the determination of policy choices will be completed in the second quarter of calendar 2010.

Until the analysis is fully completed, the impact on the Company's future results of operations and financial position is not determinable. The Company plans to complete the opening balance sheet in the second quarter of calendar 2010. The Company anticipates that there will be a significant increase in disclosure resulting from the adoption of IFRS. The Company also expects the transition to IFRS to impact financial reporting, business processes, internal controls and information systems.

Consolidated Financial Statements and Non-Controlling Interest
In January 2009, the CICA issued Handbook section 1601, Consolidated Financial Statements, and Handbook Section 1602, Non-Controlling Interest, which replace the existing standards. These sections carry forward existing Canadian guidance for preparing consolidated financial statements containing or excluding non-controlling interests. The sections are effective for interim and annual financial statements beginning on January 1, 2011 and earlier adoption is permitted. The Company is currently assessing the outcome of adopting these standards on its consolidated financial statements.

Business Combinations
In January 2009, the CICA issued Handbook Section 1582, Business Combinations, which replaces Section 1581, Business Combinations. It provides guidance on improving the relevance, reliability and comparability of the information disclosed about a business combination and its effects. This section is applied prospectively for business combinations for which the acquisition date is on or after the first annual reporting beginning on or after January 1, 2011 and earlier adoption is permitted. The Company is currently assessing the outcome of adopting this standard on its consolidated financial statements.

3. INTANGIBLE ASSETS

	2010		2009	
	Cost $	**Accumulated amortization** $	**Cost** $	**Accumulated amortization** $
Immunotherapy technology	**157,500**	**17,500**	—	—
Hypocrellin based technology and licenses	**2,476,822**	**2,476,822**	2,476,822	2,476,822
CDK technology	**225,000**	**225,000**	225,000	225,000
	2,859,322	**2,719,322**	2,701,822	2,701,822
Net book value	**140,000**		—	

During the year, amortization of intangible assets was $17,500 (2009 – nil). As at January 31, 2010, the Company performed a review of the carrying value of intangible assets and determined that no impairment charge was required.

CORE TECHNOLOGIES

Immunotherapy technology and licenses ("Immunotherapy Technology")
During September, 2009, the Company signed a technology purchase agreement with Paladin Labs Inc. ("Paladin") to acquire the proprietary rights and intellectual property related to an antibody immunotherapy technology. Under this technology, the Company acquired product candidates consisting of five monoclonal antibodies targeting certain tumor antigens that are presented in a variety of cancers. Under the terms of the agreement, consideration for the purchase consisted of a cash payment of $37,500 and the issuance of 1,500,000 common shares upon the effective date of the purchase and an additional 1,500,000 common shares to be issued no later than December 31, 2010. The common shares issued on the effective date and those to be issued prior to December 31, 2010 were valued for accounting purposes at $0.04 per share, which reflected the closing price of the common shares on the effective date of the purchase ($60,000 and $60,000, respectively). Under the terms of the agreement, a further 2,000,000 common shares are contingently issuable upon successful future financing initiatives by the Company. The agreement also requires the Company to make milestone and royalty payments to Paladin on future revenues.

3. INTANGIBLE ASSETS (CONTINUED)

Hypocrellin based technology and licenses (proprietary rights)
The Company's subsidiary, Sonolight, holds the exclusive worldwide license to develop, commercialize and exploit several proprietary inventions involving a class of sonosensitizers and their use in cancer and non-cancer therapies. Sonolight signed a licensing agreement dated March 6, 2001 with the University of Alberta. The license agreement is for a term of 25 years. The agreement requires royalty payments upon successful sales and marketing of products developed using the technology. The Company has amortized this asset on a straight-line basis over a three-year period that commenced August 1, 2001. This intangible asset is fully amortized. The Company has pledged this technology as collateral in connection with the convertible debenture (note 6).

NON-CORE TECHNOLOGIES - CDK technology (proprietary rights)
The Company owns the worldwide rights to develop, manufacture and sell the CDK technology, a novel immunomodulator with anti-cancer properties. As consideration for its acquisition of the technology, the Company must issue 400,000 common shares as certain milestones outlined in the technology purchase agreement are met. To date, the Company has issued 200,000 shares under the agreement: 100,000 shares issued in fiscal 2004 and 100,000 shares in fiscal 2003. These shares have been recorded at a value that represents the closing price of the common shares on the date the shares were issued. The Company amortized this asset on a straight-line basis over a three-year period, which commenced on August 1, 2002. This intangible asset is fully amortized. During fiscal 2009, the Company determined that it will not proceed with further development with respect to the CDK technology at this time.

4. PROPERTY AND EQUIPMENT

	2010		2009	
	Cost	**Accumulated amortization**	**Cost**	**Accumulated amortization**
	$	$	$	$
Computer equipment	**80,744**	**69,515**	74,878	66,273
Furniture and fixtures	**12,114**	**11,138**	12,114	10,720
Office equipment	**31,494**	**29,918**	31,494	29,242
Manufacturing and R&D equipment	**456,084**	**294,090**	441,838	228,310
Deposit on manufacturing and R&D equipment	**—**	**—**	12,245	—
Leasehold improvements	**2,305**	**200**	—	—
	582,741	**404,861**	572,569	334,545
Net book value	**177,880**		238,024	

During the year, amortization of property and equipment was $70,315 (2009 - $40,203). During the year ended January 31, 2009, the Company recorded an impairment charge of $12,128 against property and equipment comprised of write-downs of $5,328 and a loss on disposal of $6,800. In January 2009, the Company paid a non-refundable deposit of $12,245 in connection with the purchase of property and equipment.

5. MARKETABLE SECURITIES

Bionex technology and license (proprietary rights)
The Company held the exclusive worldwide rights to develop, manufacture and sell Bionex, a family of novel disinfectants used for multiple applications. On December 21, 2007, and amended on April 18, 2008, the Company signed a technology transfer agreement with a third party to sell its interest in the Bionex technology. Under the terms of the agreement, the Company received cash of $50,000, 1,351,111 common shares of Toba Industries Ltd. (afterwards known as Brand Marvel Worldwide Consumer Products Corporation) with a deemed fair market value of $163,048, which was included in marketable securities, and future royalties of up to $200,000 upon the successful commercialization of Bionex related products. The Company also paid $7,500 in fees related to the sale. The future royalties have not been recorded as the successful commercialization is currently indeterminable.

5. MARKETABLE SECURITIES (CONTINUED)

The Company currently holds the following marketable securities which are recorded as follows:

	2010 $	2009 $
1,351,111 common shares of Brand Marvel Worldwide Consumer Products Corporation (BMW.v)	**47,289**	52,218
8,334 common shares of Samaritan Pharmaceuticals Inc. (SPHC)	**583**	792
	47,872	53,010

During the year ended January 31, 2010, the Company recorded a fair value adjustment of $5,138 (2009 – $113,705) in connection with the above noted shares.

6. CONVERTIBLE DEBENTURE

On March 23, 2005, the Company entered into an agreement to issue a $1,000,000 principal amount 8% convertible debenture with a one-year maturity to two arm's-length parties. The debenture is collateralized by the Company's Hypocrellin based technology, one of its core technologies (note 3). The debenture was repayable in blended monthly installments of $6,667 with the balance, including accrued interest, due on March 22, 2006. The debenture had a conversion feature whereby it could be converted into common shares of the Company at a price of $0.45 per common share and could be redeemed at any time by the Company. The Company obtained extensions to the maturity date, and as at January 31, 2010, the maturity date had been extended to March 22, 2010. Subsequent to year end, the debenture holders agreed to extend the maturity date to March 22, 2011 (see Subsequent Events, note 19). In connection with prior extensions, the debenture interest rate was revised from 8% to 9% per annum and the debenture conversion price was amended from $0.45 to $0.25 per common share. During 2008, the Company made principal payments of $500,000 against the convertible debenture.

The Company has used the residual value method to allocate the proceeds of $500,000 between the liability component and the equity component based on a Black-Scholes option pricing model assuming an expected life of one year, dividend yield of 0%, average expected volatility of 99.5% and an average risk-free interest rate of 2.18%. The equity component was calculated to be $60,000. The liability component is accreted to the face value of the debenture over its term and the accretion charge was accounted for as interest expense. At January 31, 2010, the liability component was calculated to be $500,000 (2009 - $497,137).

6. CONVERTIBLE DEBENTURE (CONTINUED)

During the year ended January 31, 2010, the Company incurred $47,863 (2009 - $62,137) in interest under this convertible debenture, of which $2,863 (2009 - $17,137) was in the form of accreted interest.

7. LICENSE FEES

On April 30, 2007, the Company signed a license agreement granting an exclusive license for multinational rights to the Company's proprietary SonoLight Technology for dermatology applications (excluding cosmetic hair removal applications in Asia and acne applications in Korea). Under the terms of the agreement, the licensee was responsible for dermatology related development and commercialization activities outside of Canada. Under the terms of the license agreement, the Company was to receive license fees and the right to royalties on future sales and certain payments on the achievement of specified milestones defined in the agreement. In November 2008, the Company took steps to repatriate these multinational rights from the licensee as the licensee had failed to abide by certain terms of the agreement. As a result, during fiscal 2009, the Company informed the licensee in writing of the termination of the license agreement.

On December 14, 2007, the Company signed a license agreement to receive $3,000,000 to develop oncology products based on its SonoLight Technology. Under the terms of the agreement, the Company received $1,000,000 on execution of the agreement with an additional $1,500,000 received during fiscal 2009. During fiscal 2010, the Company received the final $500,000 license fee in connection with this agreement. The license agreement requires the Company to pay royalties on all future net revenue from the commercialization of the Company's oncology products. Under the terms of the agreement, the Company is required to use commercially reasonable efforts to initiate a Phase 1 clinical trial for photodynamic therapy treatment of prostate cancer. The Company has recognized the license fee in relation to the costs incurred with these efforts and has recognized $750,000 of the license fee for the year ended January 31, 2010 (2009 - $2,000,000).

8. INCOME TAXES

Details of the components of income taxes are as follows:

	2010 $	2009 $
Loss from operations	**(517,799)**	(204,047)
Statutory tax rate	**28.92%**	29.46%
Tax recovery at Canadian statutory rate	**(149,747)**	(60,108)
Adjustment in income taxes resulting from:		
Non-deductible stock-based compensation expense	**20,482**	6,039
Impact on future tax assets resulting from statutory rate reduction and expiry of loss carryforwards	**278,511**	379,554
Non-deductible expenses and other	**2,536**	10,261
Valuation allowance	**(151,782)**	(335,746)
Future tax recovery	**—**	—

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

	2010 $	2009 $
Future tax assets		
Non-capital loss carryforwards	**2,560,639**	3,316,528
Tax cost of property and equipment in excess of book values	**211,118**	193,539
Tax cost of intangible assets in excess of book values	**109,371**	104,996
Scientific research and experimental development tax credits	**677,794**	92,321
Share issue costs deductible for tax purposes	**7,135**	11,098
Capital loss carryforwards	**834,069**	833,427
	4,400,126	4,551,909
Valuation allowance	**(4,400,126)**	(4,551,909)
	—	—

8. INCOME TAXES (CONTINUED)

The Company and its subsidiaries have non-capital losses for income tax purposes of approximately $10,083,000 at January 31, 2010 (2009 - $12,806,000) that may be applied against future taxable income. In addition, the Company has scientific research and experimental development expenses of approximately $2,711,000 (2009 - $369,000). In total, approximately $10,083,000 (2009 - $12,806,000) of non-capital losses and $7,357,000 (2009 - $4,939,000) of deductible temporary differences for Canadian income tax purposes have not been recognized for accounting purposes. The non-capital losses and investment tax credits ("ITC") available for carry forward will expire as follows:

	Non-capital losses $	**ITC** $
2011	2,682,253	—
2012	—	64,000
2013	—	9,600
2015	1,936,483	—
2026	2,390,957	—
2027	1,943,198	91,000
2028	1,129,979	99,000
2029	97	200,000
2030	122	—
	10,083,089	463,600

9. COMMITMENTS AND CONTINGENCIES

a) Lease obligations

The Company is committed to lease payments, including estimated operating costs, for its business premises as follows to August 31, 2011:

	Operations $
2011	40,848
2012	23,828
	64,676

Of the operating lease expense of $38,915 incurred during 2010 (2009 - $37,682), $11,675 (2009 - $11,305) was recorded in general and administrative expense and $27,240 (2009 - $26,377) was recorded in research and development expense.

b) Research and development, and other

The Company has commitments to fund various research and development activities in the normal course of its business. Subject to successful completion of contractual milestones, the Company is committed to approximately $269,000 of research and development expenditures for fiscal 2011.

In fiscal 2008, the Company entered into a collaborative agreement for product development with the Alberta Research Council (the "ARC") whereby the ARC agreed to incur up to $200,000 worth of expenditures to develop a fermentation based method to manufacture Hypocrellin B. Upon commercial sales of the developed product, the Company has committed to reimburse the ARC for its expenditures plus a 25% premium. This product development has not reached the commercialization stage and the outcome is not yet determinable.

In fiscal 2010, the Company entered into an assumption agreement (the "Assumption Agreement") with the Alberta Heritage Foundation for Medical Research (the "Foundation") in connection with the Company's September 2009 purchase of the Immunotherapy Technology (note 3). This related to prior Foundation funding of $500,000 towards the development of the Immunotherapy Technology. Under the Assumption Agreement, upon the generation of revenues related to any developed product, the Company has committed to reimburse the Foundation for its $500,000 funding and to pay a royalty of $500,000 based on product revenues. This technology has not reached the commercialization stage and the outcome is not yet determinable.

10. SHARE CAPITAL

Authorized

Unlimited number of common shares without nominal or par value
Unlimited number of first preferred shares
Unlimited number of second preferred shares

The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

Issued

	Number of common shares	Amount $
Common shares		
At January 31, 2009 and 2008	68,197,580	23,998,875
Shares issued pursuant to a technology purchase (note 3)	1,500,000	60,000
At January 31, 2010	**69,697,580**	**24,058,875**

At January 31, 2010, the Company held nil (2009 - 22,540) common shares for cancellation.

On October 15, 2006, the Company signed an exclusive agreement with KMH Co, Ltd ("KMH") for the distribution rights of the SL017 topical gel variant of its Hypocrellin based technology in Asia for fifteen years or until the expiration of patents, whichever is longer. The agreement required an initial investment in the Company of $200,000 with additional investments of up to $1,300,000 upon the achievement of specified milestones as well as specified royalty payments on product sales. In addition, the Company has committed to issuing up to 5,000,000 additional shares to KMH contingent on whether the product meets the clinical endpoints as outlined in the Health Canada approved clinical trial protocol.

10. SHARE CAPITAL (CONTINUED)

Under the terms of the agreement, the Company issued 1,000,000 common shares to KMH. Of the $200,000 initial investment, $120,000 was recorded as deferred revenue which will be recognized into income over the fifteen-year term of the agreement. In 2010, the Company recognized $8,000 (2009 - $8,000) of the deferred amount into income. The remaining $80,000 was applied to share capital based on the fair value of the shares at the date of the agreement with KMH.

In September 2009, the Company issued 1,500,000 common shares as partial consideration under a technology purchase agreement. The shares have been recorded at a value of $60,000 ($0.04 per share) which represents the closing price of the Company's common shares on the date the shares were issued.

The following options to purchase common shares were outstanding as at January 31, 2010:

Exercise price $	Options outstanding #	Weighted average remaining life (years)	Options exercisable #
0.10	**950,000**	**10.00**	**950,000**
0.15	**525,000**	**2.99**	**525,000**
0.25	**2,606,000**	**1.88**	**2,556,000**
1.00	**250,000**	**0.05**	**250,000**
	4,331,000	**3.69**	**4,281,000**

10. SHARE CAPITAL (CONTINUED)

The following schedule details the warrants and stock options granted, exercised and expired:

	Shares issuable on exercise of			
	Warrants		Stock options	
	Number of shares #	Weighted average exercise price $	Number of shares #	Weighted average exercise price $
Balance, January 31, 2008	4,800,000	0.20	3,902,000	0.32
Granted	—	—	350,000	0.16
Expired	(4,800,000)	0.20	(68,000)	0.56
Balance, January 31, 2009	—	—	4,184,000	0.31
Granted	—	—	1,775,000	0.16
Expired	—	—	(1,628,000)	0.27
Balance, January 31, 2010	—	—	**4,331,000**	**0.26**

Warrants

In March 2007, the Company issued 4,800,000 share purchase warrants exercisable at $0.20 per common share pursuant to a private placement of units. These warrants were set to expire 12 months from the date of issue. In March 2008, the Company received approval from the TSX Venture Exchange to extend the expiry date of the warrants to September 19, 2008. During the year ended January 31, 2009, these warrants expired without exercise and the recorded value of $144,000 was reclassified to contributed surplus.

Stock options

For the year ended January 31, 2010, the Company granted 1,775,000 stock options, as per the Company's Stock Option Plan. Out of this total, 825,000 stock options with exercise prices ranging from $0.15 to $0.25 were granted to non-employees and 950,000 stock options with an exercise price of $0.10 were granted to employees (note 12).

10. SHARE CAPITAL (CONTINUED)

For the year ended January 31, 2009, the Company granted 350,000 stock options, as per the Company's Stock Option Plan. Out of this total, 300,000 stock options with an exercise price of $0.15 were granted to non-employees and 50,000 stock options with an exercise price of $0.25 were granted to an employee (note 12).

On January 26, 2010, the Company received shareholder and regulatory approval to amend the Company's Stock Option Plan such that the aggregate number of common shares eligible for issuance under the Stock Option Plan shall not exceed 8,000,000. At January 31, 2010, 3,669,000 options are available for issue.

Escrowed shares

As at January 31, 2010, the Company's transfer agent held nil [2009 – 603,577] common shares pursuant to a time-based escrow agreement (prior to October 31, 2004, these shares were subject to a TSX Venture Exchange performance-based escrow agreement). These shares were automatically released over time through to October 30, 2009.

Contributed surplus

	2010 $	**2009** $
Contributed surplus, beginning of year	**1,603,615**	1,439,115
Stock-based compensation expense	**70,750**	20,500
Expiration of warrants	**—**	144,000
Contributed surplus, end of year	**1,674,365**	1,603,615

11. CAPITAL DISCLOSURES

The Company is a biotechnology company and, consistent with other companies in the industry, the Company's objectives when managing capital are to safeguard its accumulated capital in order to maintain its ability to continue as a going concern so that it can continue with its drug development program and strive to maximize shareholder value. Note 1 provides a discussion surrounding the Company's ability to continue as a going concern. Capital is defined by the Company as shareholders' (deficiency) equity (primarily comprised of share capital, contributed surplus and deficit) and current term debt consisting of a convertible debenture. The Company manages its capital structures and makes adjustments based on the needs of the Company's operations and the requirement for funding to continue with the Company's drug development program. The Company does this through new share or debt issuances, selling assets or licensing its technologies to third parties to fund operations. The Company is not subject to externally imposed capital requirements.

12. STOCK-BASED COMPENSATION

For the year ended January 31, 2010, the Company granted a total of 1,775,000 (2009 – 350,000) stock options under the Company's Stock Option Plan. The fair value of options vesting in 2010 of $70,750 (2009 - $20,500) was recognized as an expense and credited to contributed surplus for the year ended January 31, 2010.

The Company used the Black-Scholes option pricing model to estimate the fair value of these options. The following assumptions were used:

	2010	**2009**
Dividend yield	**0.00%**	0.00%
Volatility	**129 - 178%**	124 - 143%
Risk-free interest rate	**1.30 - 3.90%**	2.48 - 3.08%
Expected life (years)	**2.00 - 10.00**	4.50 - 5.00
Fair value per option	**$0.03 - $0.05**	$0.05 - $0.06

13. DEFERRED REVENUE

The Company has recorded deferred revenue in connection with license fees and market distribution rights received but not earned as follows:

	2010 $	2009 $
License fees *(note 7)*	**—**	250,000
Market distribution rights *(note 10)*	**93,667**	101,667
	93,667	351,667
Less current portion	**8,000**	258,000
Long-term portion	**85,667**	93,667

14. SEGMENT DISCLOSURES

The Company is managed as one operating segment – biopharmaceutical / pharmaceutical products. Management assesses performance and makes resource decisions based on the consolidated results of operations of this operating segment. Substantially all of the operations of the Company are directly engaged in or support this operating segment. The following table presents information on the Company's operating results for the years ended January 31, 2010 and 2009, by geographic area.

Revenues by geographic area

	2010 $	2009 $
Canada	**—**	—
United States	**—**	—
Asia	**758,000**	2,008,000
	758,000	2,008,000

Revenues are attributed to countries based on location of customers or counterparties. Revenues represent market distribution rights and license fees earned during the year.

15. DEMAND LOANS AND RELATED PARTY TRANSACTIONS

For the years ended January 31, 2010 and 2009, there were no related party transactions.

Subsequent to year end, the Company entered into a demand loan agreement with one of its officers to provide up to $1,000,000 bearing interest at 8% compounded annually to be used for the Company's operating expenditures. This financing is unsecured and has no fixed terms of repayment, with interest payable monthly. To date, the Company has drawn $400,000 on this financing (see Subsequent Events, note 19).

16. NET CHANGE IN NON-CASH WORKING CAPITAL ITEMS RELATED TO OPERATING ACTIVITIES

	2010 $	**2009** $
Accounts receivable	**(50,055)**	114,276
Prepaid expenses	**31,285**	(17,917)
Accounts payable and accrued liabilities	**112,600**	41,647
	93,830	138,006

During the year ended January 31, 2010, the Company paid approximately $46,100 of interest (2009 - $46,450) and income taxes of nil (2009 – nil).

17. GOVERNMENT ASSISTANCE

In April 2008, the Company obtained federal government assistance in the form of an NRC-IRAP grant to cover salaries and contractor fees related to the development of the Company's Sonodynamic therapy for the treatment of peritoneal carcinomatosis and pleural effusion. During the year ended January 31, 2010, the Company received $85,553 (2009 – $112,809) of funding, of which $85,553 (2009 - $95,578) was recognized as a reduction of research and development expenses and nil (2009 - $17,231) was netted against manufacturing and R&D equipment.

17. GOVERNMENT ASSISTANCE (CONTINUED)

During the year ended January 31, 2010, the Company recognized $3,733 from Alberta Finance and $92,568 from Revenue Quebec related to scientific research and experimental development claims made for research and development expenditures incurred in fiscal 2007, 2008 and 2009. This funding was treated as a reduction of research and development expenses.

	2010 $	**2009** $
Gross research and development expenses	**600,917**	1,540,758
Less government assistance	**(181,854)**	(95,578)
Research and development expenses, net	**419,063**	1,445,180

18. FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities and the convertible debenture.

a) Carrying value and fair value

The carrying values of cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities and the convertible debenture approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair values of other financial instruments reflect the Company's best estimate based upon estimated interest rates at which the Company believes it could enter into with similar instruments at the consolidated balance sheet dates. The fair value of the Company's financial instruments of cash and cash equivalents and marketable securities are measured using a Level 1 classification.

b) Risks

i) Foreign currency risk

The Company has certain assets and liabilities that are denominated in foreign currencies and are exposed to risks from changes in foreign exchange rates and the degree of volatility of these rates. Due to the limited number of transactions that are denominated in foreign currencies, the Company does not consider its exposure to foreign currency risk to be significant and currently does not use derivative instruments to reduce its exposure to foreign currency risk.

18. FINANCIAL INSTRUMENTS (CONTINUED)

At year end the Company's exposure to foreign currency risk is US$29,119 in accounts payable. The year-end rate of conversion of U.S. to Canadian dollars is 1.0650. Based on the foreign currency exposures noted above, a 10 percent strengthening of the Canadian dollar would have decreased the net loss by $3,100, assuming that all other variables remain unchanged. A 10 percent weakening of the Canadian dollar would have an equal but opposite effect, assuming that all other variables remain unchanged.

ii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's exposure to liquidity risk is dependent on its ability to raise funds to meet its commitments and sustain its operations. The Company controls liquidity risk by managing its working capital and by securing additional funds through equity, debt or partnering transactions (see Capital Disclosures, note 11). Subsequent to the year end, in February 2010, the Company secured debt financing from one of its officers to provide up to $1,000,000 in demand loan financing for operational expenditures (note 15). In March 2010, the Company renegotiated the maturity of its convertible debenture to March 22, 2011.

iii) Credit risk

Financial instruments that subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. To minimize its exposure to credit risk for cash equivalents, the Company invests surplus cash in short-term deposits that are fully guaranteed by the Company's financial banker, a major Canadian bank. As the Company is a research and development company, the Company's exposure to credit risk related to accounts receivable is not considered to be significant. At year end, 97% of accounts receivable were due from federal or provincial government agencies (85% from one agency).

iv) Market risk

The Company owns investments in common shares of publicly traded companies that subject the Company to market risk. As market prices change, the Company's income and the value of its marketable securities are affected. The Company expects that its exposure to market risk will be short lived as the investments are viewed as temporary in nature. At year end, a 10 percent increase in the market price of those shares would have decreased the net loss by $4,787, assuming that all other variables remain unchanged. A 10 percent decrease in the market price would have increased the net loss by $4,787, assuming that all other variables remained unchanged.

18. FINANCIAL INSTRUMENTS (CONTINUED)

v) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents are comprised of highly liquid deposits or investments that earn interest at market rates. Interest on the long-term debt is at fixed rates. Consequently, the Company is exposed to fair value changes on long-term debt when the market rate of interest changes. Accounts receivable and accounts payable and accrued liabilities bear no interest.

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company's policy limits the investing of excess funds to liquid government guaranteed deposits or guaranteed investment certificates.

19. SUBSEQUENT EVENTS

On February 3, 2010, the Company entered into a demand loan agreement with one of its officers to provide up to $1,000,000 bearing interest at 8% compounded annually to be used for the Company's operating expenditures. This financing is unsecured and has no fixed terms of repayment, with interest payable monthly. To date, the Company has drawn $400,000 on this financing.

In February 2010, the Company signed agreements granting 100,000 stock options to consultants of the Company. The stock options are exercisable at a price of $0.10 per common share, vest immediately and carry an expiry date of February 18, 2020.

In February and March 2010, the Company received approximately $92,000 of funding from Alberta Finance and from Revenue Quebec related to scientific research and experimental development claims for research and development expenditures incurred in fiscal 2009.

On March 22, 2010, the Company signed an agreement with its convertible debenture holders to extend the date of maturity by one year. Under the agreement, the convertible debenture has a maturity date of March 22, 2011, with all other conditions remaining unchanged.