

Financial Statements

ConjuChem Biotechnologies Inc.

October 31, 2009 and 2008

ConjuChem Biotechnologies Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Property, plant and equipment and intangible assets

Property, plant and equipment and intangible assets are recorded at cost less related investment tax credits and other government assistance, and are amortized over their estimated useful lives according to the following methods and rates:

Research equipment	Declining balance	20%
Computer equipment	Declining balance	30%
Furniture and fixtures	Declining balance	20%
Leasehold improvements	Straight-line	Lease term
Computer software	Declining balance	50%
Licensed technology	Straight-line	3 years

Impairment of long-lived assets

Property, plant and equipment and intangible assets are regularly reviewed for impairment whenever events or changes in circumstances indicate that their carrying values may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use plus its residual value. If such an asset is considered impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value, generally determined on a discounted cash flow basis.

Revenue recognition

The Company records revenues from research and development contracts based on the performance criteria of each contract. Revenues are recognized as the contract work is performed or as milestones are achieved, when the price is fixed and determinable, and when collection is reasonably assured. Up-front payments for the use of technology or fees received on the signing of research agreements are recognized over the period of performance of the related activities. Amounts received in advance of recognition are shown as unearned revenue.

Stock-based compensation

The Company has a stock-based compensation plan, which is described in note 9. The Company applies the fair value method to expense all stock options awarded since November 1, 2001. Options issued to employees, officers and directors are recognized as an expense over the vesting period. Options issued to consultants are recognized as an expense at the earlier of the vesting date or over the period over which the services are performed. The fair value is determined using the Black-Scholes option pricing model. Any consideration paid by employees, officers and directors on exercise of stock options or purchase of stock is credited to share capital.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Government assistance

Grant amounts resulting from government assistance programs, including investment tax credits for research and development expenditures, are reflected as reductions of the cost of the assets or expenditures to which they relate at the time the assistance becomes receivable.

Research and development

Research costs are charged against income in the year of expenditure on an accrual basis. Development costs are charged against income in the year of expenditure on an accrual basis unless a development project meets the criteria under Canadian GAAP for deferral and amortization. The Company has not deferred any such development costs to date.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange prevailing at the balance sheets date with the impact being recorded in the statements of operations. Revenues and expenses and other assets and liabilities are translated into Canadian dollars at rates of exchange in effect at the related transaction dates. Foreign currency translation gains and losses on available-for-sale short-term investments are recorded as a component of accumulated other comprehensive loss until the related asset or liability is removed from the balance sheets, at which time they are included in the statements of operations of the reporting period.

Income taxes

The Company follows the liability method of accounting for income taxes under which future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the periods during which assets or liabilities are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

Earnings per share

Basic earnings per share are calculated using the weighted-average number of common shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method. The exercise of stock options and warrants and the conversion of the convertible senior unsecured notes are anti-dilutive for all years presented.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Share issue costs

Share issue costs incurred by the Company are recorded as a reduction in capital stock.

Convertible unsecured subordinated debentures

The carrying value of convertible unsecured subordinated debentures is being accreted to its maturity value through charges to income over the term of the debentures based on the effective yield method.

Financing costs

Financing costs allocated to the issuance of debt are deferred and amortized over the term of the related debt using the effective yield method, and presented as a reduction of the related debt.

Financial instruments

All financial assets and liabilities are classified based on their inherent characteristics and management's intended use. When they are initially recognized, all financial assets are classified as held-for-trading, held-to-maturity, available-for-sale or loans and receivables, while financial liabilities are classified as held-for-trading or other financial liabilities. Upon initial recognition, all financial assets and liabilities are recorded at fair value in the balance sheets. In subsequent periods, they are measured at fair value, except for financial assets held-to-maturity, loans and receivables and financial liabilities not held for trading purposes which are measured at amortized cost calculated using the effective interest rate method. The Company has selected the following classifications and measurements for its financial assets and liabilities:

	Classification	Measurement
Cash and cash equivalents	Available-for-sale	Fair value
Investments	Available-for-sale	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Convertible unsecured subordinated debentures	Other financial liabilities	Amortized cost

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3. CHANGE IN ACCOUNTING POLICIES

The Canadian Institute of Chartered Accountants [“CICA”] has issued the following new *Handbook* Sections which are effective for the Company for interim and annual reporting periods beginning after November 1, 2008:

Section 1400, *General Standards of Financial Statement Presentation*, has been amended to include requirements for management to assess and disclose an entity’s ability to continue as a going concern. The adoption of this Section is reflected in note 1.

Section 3064, *Goodwill and Intangible Assets*, which replaces Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*, establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company has adopted these amendments and the impact of this adoption is not material.

In May 2009, the CICA amended Section 3862, *Financial Instruments – Disclosures*, to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than Level 1 quoted prices for which all significant inputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to Section 3862 are effective for the Company’s interim and annual financial statements beginning on October 1, 2009.

Future accounting pronouncements

In January 2009, the CICA issued *Handbook* Section 1582, *Business Combinations*, which replaces *CICA Handbook* Section 1581, *Business Combinations*. Section 1582 establishes standards for the accounting for business combinations and is applicable for the Company’s business combinations with acquisition dates on or after January 1, 2011. Early adoption of this Section is permitted.

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4. INVESTMENTS

	2009 \$	2008 \$
Guaranteed investment certificates, earning interest at rates ranging from 0.20% to 1.40% [2008 – 2.15%] and maturing on various dates from January 2010 to September 2010 [2008 – July 2009]	5,717,766	100,553
Discount notes, earning interest at rates ranging from 2.48% to 3.00% and matured on various dates from January 2009 to February 2009	—	11,595,974
Bankers' acceptance, earning interest at a rate of 4.52% and matured in November 2008	—	1,756,832
Corporate bonds, earning interest at rates ranging from 2.72% to 3.02% and matured on various dates from January 2009 to February 2009	—	5,481,378
	<u>5,717,766</u>	<u>18,934,737</u>

Investments are comprised of five guaranteed investment certificates issued by five major Canadian chartered banks [2008 – one guaranteed investment certificate], nil investments in discount notes [2008 – six investments], nil in bankers' acceptance [2008 – one bankers' acceptance] and nil corporate bonds [2008 – two corporate bonds] all issued by large unrelated corporations.

As of October 31, 2009 and 2008, a guaranteed investment certificate for an amount of \$100,000, collateralizes the Company's corporate credit cards.

5. ACCOUNTS RECEIVABLE

	2009 \$	2008 \$
Withholding tax receivable [note 11]	880,892	—
Commodity taxes receivable	137,374	80,075
Receivables from employees	26,552	80,569
Other receivables	42,852	—
	<u>1,087,670</u>	<u>160,644</u>

The amount receivable from employees pertains to tax equalization advances made to officers of the Company which will be repaid to the Company shortly after October 31, 2009.

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6. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated amortization \$	Net carrying value \$
2009			
Research equipment	2,549,620	2,031,463	518,157
Computer equipment	643,153	592,546	50,607
Furniture and fixtures	347,201	280,415	66,786
Leasehold improvements	130,341	130,341	—
	3,670,315	3,034,765	635,550
2008			
Research equipment	3,001,686	2,312,406	689,280
Computer equipment	644,544	574,236	70,308
Furniture and fixtures	373,355	291,258	82,097
Leasehold improvements	130,341	130,341	—
	4,149,926	3,308,241	841,685

7. INTANGIBLE ASSETS

	Cost \$	Accumulated amortization \$	Net carrying value \$
2009			
Computer software	477,503	471,950	5,553
Licensed technology	6,707,795	6,707,794	1
	7,185,298	7,179,744	5,554
2008			
Computer software	477,503	466,396	11,107
Licensed technology	6,707,795	6,707,794	1
	7,185,298	7,174,190	11,108

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8. CONVERTIBLE SENIOR UNSECURED NOTES AND CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

Convertible senior unsecured notes

On November 30, 2007, the Company repaid its convertible senior unsecured notes amounting to \$45,000,000 plus accrued interest of \$13,006,914 for a total amount of \$58,006,914 by redeeming an equivalent amount of long-term investments. Since the Company redeemed the long-term investments prior to their maturity, the Company incurred a loss of \$267,439 on redemption. In addition, as the carrying value of the convertible senior unsecured notes was accreted to its maturity value over its life through charges to income and the convertible senior unsecured notes were redeemed prior to maturity, an accelerated accretion of \$5,161,984, for a total accretion of \$5,504,427, was charged to income in the year ended October 31, 2008. Upon repayment, the equity portion of convertible senior unsecured notes amounting to \$14,996,780 was transferred to contributed surplus.

Convertible unsecured subordinated debentures

On December 13, 2007, the Company closed a bought deal financing of 22,000 convertible unsecured subordinated debentures units of the Company [a "Unit"] at a price of \$1,000 per Unit. Each Unit consists of \$1,000 principal amount of convertible unsecured subordinated debentures and 1,562.5 common share purchase warrants. The debentures bear interest at an annual rate of 8.0% payable semi-annually, commencing on June 30, 2008, and mature on December 31, 2010. The debentures may be redeemed on or after December 31, 2009, and prior to the maturity date, at a redemption price equal to \$1,050 per debenture plus accrued and unpaid interest under certain conditions. The debentures can be converted at any time, at the option of the holder, into common shares of the Company at a price of \$0.16 per share. In addition, each full warrant entitles the holder to purchase one common share of the Company at a price of \$0.25 until December 31, 2011. The offering was completed resulting in the issuance of a total of 22,000 Units for gross proceeds of \$22,000,000 and net proceeds of \$20,235,586. The fair value of the Company's obligation to make principal and interest payments was estimated at \$13,500,000 and was recorded as convertible unsecured subordinated debentures. The fair value of the holders' conversion option and warrants were estimated at \$6,100,000 and \$2,400,000, respectively and were recorded as "equity portion of convertible unsecured subordinated debentures" and "warrants", respectively. The fair value of the holders' conversion option was determined using a conversion option pricing model while the fair value of the warrants was determined using the Black-Scholes option pricing model. The financing costs totaling \$1,764,414 related to the issuance of these units have been allocated pro-rata to convertible unsecured subordinated debentures amounting to \$1,082,710, equity portion of convertible unsecured subordinated debentures amounting to \$489,223 and warrants amounting to \$192,481. The carrying value of the convertible unsecured subordinated debentures is accreted to its maturity value over its life through charges to income, using a notional interest rate of 27%.

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8. CONVERTIBLE SENIOR UNSECURED NOTES AND CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES [Cont'd]

A director of the Company is a managing partner of an investment fund that manages investing partnerships holding an aggregate of \$3.5 million of the \$22 million principal amount of convertible unsecured subordinated debentures.

The carrying value of the convertible unsecured subordinated debentures is detailed as follows as at October 31, 2009 and 2008:

	2009	2008
	\$	\$
Fair value upon issuance	13,500,000	13,500,000
Accumulated accretion expense	4,485,875	1,873,478
Less: Unamortized portion of deferred financing costs	(412,733)	(735,277)
Less: Cumulative portion of the carrying value attributable to the 1,670 units converted into common stock [1,635 units in 2008]	(1,024,773)	(1,003,295)
	<u>16,548,369</u>	<u>13,634,906</u>

9. SHAREHOLDERS' DEFICIENCY

Capital stock

Authorized

An unlimited number of common shares.

Issued and outstanding

	Number of common shares #	Stated capital \$
Balance as at October 31, 2007	240,213,668	265,332,302
Issued upon conversion of debentures	10,218,750	1,491,433
Balance as at October 31, 2008	<u>250,432,418</u>	<u>266,823,735</u>
Issued upon conversion of debentures	218,750	34,900
Balance as at October 31, 2009	<u>250,651,168</u>	<u>266,858,635</u>

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9. SHAREHOLDERS' DEFICIENCY [Cont'd]

Contributed surplus

	\$
Balance as at October 31, 2007	28,008,989
Stock-based compensation for the year	2,567,057
Value of warrants transferred to contributed surplus upon expiration	3,276,000
Equity portion of convertible senior unsecured notes transferred to contributed surplus upon repayment <i>[note 8]</i>	14,966,780
Balance as at October 31, 2008	48,818,826
Stock-based compensation for the year	2,570,038
Corporate reorganization <i>[note 1]</i>	5,000,000
Costs of reorganization <i>[note 1]</i>	(855,690)
Balance as at October 31, 2009	55,533,174

Share issuances

In June 2008, holders of the convertible unsecured subordinated debentures opted to convert 1,635 units into an amount of 10,218,750 common shares of the Company. The value of \$1,491,433 allocated to the common shares issued upon conversion is comprised of the accreted carrying value of the convertible unsecured subordinated debentures at the date of conversion amounting to \$1,010,643, net of \$80,465 of deferred financing costs, the amount of unpaid accrued interest of \$63,807 and the equity portion of the convertible unsecured subordinated debentures of \$416,983.

In April 2009, holders of the convertible unsecured subordinated debentures opted to convert 35 units into an amount of 218,750 common shares of the Company. The value of \$34,900 allocated to the common shares issued upon conversion is comprised of the accreted carrying value of the convertible unsecured subordinated debentures at the date of conversion amounting to \$25,130, net of \$1,722 of deferred financing costs, the amount of unpaid accrued interest of \$844 and the equity portion of the convertible unsecured subordinated debentures of \$8,926.

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9. SHAREHOLDERS' DEFICIENCY [Cont'd]

Warrants

	Number of common shares reserved for issuance	\$
Balance as at October 31, 2007	97,876,750	11,885,875
Expired warrants	(1,050,000)	(3,276,000)
Issued [note 8]	34,375,000	2,400,000
Issuance costs [note 8]	—	(192,481)
Balance as at October 31, 2008 and 2009	131,201,750	10,817,394

Warrants outstanding as at October 31, 2009 are as follows:

Weighted average exercise price \$	Number outstanding #	Weighted average months to expiry
1.00	96,826,750	0.9
0.25	34,375,000	26.0
0.80	131,201,750	7.5

Stock option plan

On March 27, 1998, the Company established a stock option plan [the "plan"] for directors, officers, employees, consultants and members of the scientific advisory board.

At October 31, 2009, there were 3,817,804 [2008 – 3,067,441] options available to be issued under the plan.

Options generally vest over a three- to five-year period except for Board members, for whom they vest immediately and are exercisable no later than 10 years after the grant date, subject to certain restrictions.

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9. SHAREHOLDERS' DEFICIENCY [Cont'd]

The changes to the number of stock options granted by the Company and their weighted average exercise price are as follows:

	2009		2008	
	#	\$	#	\$
Balance, beginning of year	23,848,443	0.69	15,133,865	1.16
Granted	200,000	0.11	11,113,000	0.09
Forfeited	(950,363)	1.48	(2,398,422)	1.02
Balance, end of year	23,098,080	0.64	23,848,443	0.69
Options exercisable, end of year	16,105,497	0.78	8,193,860	1.34

Additional information concerning stock options as at October 31, 2009 is as follows:

Price range \$	Options outstanding			Options exercisable	
	Number of outstanding options #	Weighted average months remaining	Weighted average exercise price \$	Number of exercisable options #	Weighted average exercise price \$
\$0.075 to \$0.095	10,022,000	90	0.09	5,296,917	0.01
\$0.12	150,000	114	0.12	—	—
\$0.40 to \$0.55	768,413	57	0.42	755,080	0.41
\$0.71 to \$0.76	9,075,000	52	0.72	7,165,417	0.72
\$0.91	40,000	52	0.91	26,666	0.91
\$1.04 to \$1.24	1,398,000	46	1.07	1,398,000	1.07
\$1.29 to \$1.80	361,500	75	1.58	305,250	1.57
\$2.00 to \$2.67	507,500	78	2.00	382,500	2.00
\$3.72	30,000	65	3.72	30,000	3.72
\$4.42 to \$4.83	606,667	60	4.73	606,667	4.73
\$5.06 to \$6.00	11,000	24	5.80	11,000	5.80
\$6.25 to \$6.28	88,000	17	6.26	88,000	6.26
\$7.50	40,000	26	7.50	40,000	7.50
\$0.075 to \$7.50	23,098,080	70	0.64	16,105,497	0.78

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9. SHAREHOLDERS' DEFICIENCY [Cont'd]

Effective November 1, 2004, the Company began recording compensation expense for awards granted to employees, officers and directors. Compensation expense amounting to \$2,570,038 [2008 – \$2,567,057] has been recorded for fiscal 2009 for direct awards of stock and stock options granted with a corresponding credit to contributed surplus. The fair value of stock options at the grant date was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	<u>2009</u>	<u>2008</u>
Black-Scholes weighted average assumptions		
Expected dividend yield	—	—
Expected volatility	124.8%	129.4%
Risk-free interest rate	1.8%	3.1%
Expected option life in years	5.0	5.0
Weighted average stock option fair value	\$ 0.08	\$ 0.08

Diluted earnings per share

No options or warrants outstanding at October 31, 2009 and 2008 were included in the calculation of diluted earnings per share, as all such securities would be anti-dilutive. At October 31, 2009, there were 23,098,080 stock options [2008 – 23,848,443] and 131,201,750 warrants outstanding [2008 – 131,201,750].

10. COMMITMENTS

Operating leases

The Company is committed under operating leases for rental of premises until January 2011 and of rental of equipment until September 2012. Future minimum annual payments required are as follows:

	<u>\$</u>
2010	533,000
2011	221,000
2012	8,000
	<u>762,000</u>

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11. INCOME TAXES

The income tax recovery reported differs from the amount of the tax recovery computed by applying Canadian federal rates and the applicable provincial rates to loss before income tax recovery. The reasons for the differences and the related tax effects are as follows:

	2009 %	2008 %
Statutory federal and provincial rate	30.90	31.09
Increase (decrease) in taxes recoverable resulting from:		
Accretion in carrying value of convertible senior unsecured notes and convertible unsecured subordinated debentures	(5.12)	(6.10)
Stock-based compensation	(5.03)	(2.00)
Unrecognized tax benefits of operating losses and other available deductions	(25.11)	(22.00)
Investment tax credits non-taxable in Quebec	1.98	0.20
Other	2.38	(1.19)
Income tax recovery	—	—

The tax effects of temporary differences and net operating losses that give rise to future income tax assets are as follows:

	2009 \$	2008 \$
Future income tax liability		
Share and debt issue expenses	111,000	—
Future income tax assets		
Tax basis of capital assets in excess of carrying values	9,233,000	23,387,000
Tax basis of eligible capital expenditures	81,000	1,362,000
Net operating and capital losses carried forward	—	20,875,000
Research and development expenditures	91,000	3,903,000
Share and debt issue expenses	—	1,256,000
Other	—	3,000
Total future income tax assets	9,405,000	50,786,000
Valuation allowance	(9,294,000)	(50,786,000)
Net future income taxes	—	—

In connection with the corporate reorganization, the tax benefits of Old ConjuChem's non-capital losses and scientific research and experimental development pool of undeducted expenditures as well as the federal non-refundable investment tax credits generated from the business through August 24, 2009 are not available to New ConjuChem.

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11. INCOME TAXES [Cont'd]

During the year ended October 31, 2008, the Company recorded an expense of \$1,335,200, based on management's estimates, related to a withholding tax contingency [including interest and penalty] upon payment of the interest, on November 30, 2007, on the Company's convertible senior unsecured notes [note 8]. During the year ended October 31, 2009, through the Voluntary Disclosure Program, management's estimates have changed, resulting in a reversal of a portion of this expense for \$1,257,000 as part of the general and administrative expenses. The Company has paid an amount of \$995,000 to Canada Revenue Agency in June 2009 which is in excess of management's estimate of the remaining exposure, therefore an amount of \$880,892 has been recorded within accounts receivable [note 5].

The Company has research and development expenditures amounting to approximately \$270,000 [2008 – \$13,430,000] which have not been deducted for federal income tax purposes and \$420,000 [2008 – \$15,875,000] for provincial income tax purposes. These expenditures are available to reduce future taxable income and have an unlimited carry-forward period. Investment tax credits receivable, research and development expenditure and withholding tax receivable amounts are based on management's estimates and are subject to verification by taxation authorities, and accordingly, these amounts may vary. The Company has no accrued share and debt issue expenses available for deduction for income tax purposes [2008 – \$5,407,000].

12. GOVERNMENT ASSISTANCE

The Company incurred research and development expenditures which are eligible for investment tax credits. The investment tax credits recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by the taxation authorities. These amounts have been recorded as a reduction of research and development expenditures as follows:

	2009	2008
	\$	\$
Investment tax credits	<u>(2,641,174)</u>	<u>(701,306)</u>

The Company has available non-refundable investment tax credits of \$72,000 [2008 – \$2,686,000] related to research and development expenditures which may be utilized to reduce federal income taxes payable in future years and that expire in 2029.

The benefits of these non-refundable investment tax credits have not been recognized in the financial statements.

During the year ended October 31, 2009, the Company has reversed tax reserves for Scientific Research and Experimental Development ["SR&ED"] tax credits for an amount of \$2,087,000 following the results of tax audits.

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13. MANAGEMENT OF CAPITAL

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders;
- to maintain a flexible capital structure which optimizes the cost of capital at an acceptable risk.

In the management of capital, the Company includes shareholders' deficiency and convertible unsecured subordinated debentures in the definition of capital, as follows:

	2009	2008
	\$	\$
Shareholders' deficiency	(9,787,919)	(808,766)
Convertible unsecured subordinated debentures	16,548,369	13,634,906
	6,760,450	12,826,140

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and short-term investment balances.

The Company expects that its current capital resources will be sufficient to carry its research and development plans and operations into the third quarter of the year ending October 31, 2010 and, therefore, a going concern uncertainty note was added to note 1.

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14. FINANCIAL INSTRUMENTS

The classification of financial instruments as at October 31, 2009 and 2008 and their respective carrying values and fair values are as follows:

	Available- for-sale \$	Loans and receivables \$	Other financial liabilities \$	Carrying value \$	Fair value \$
2009					
Financial assets					
Cash and cash equivalents	1,743,327	—	—	1,743,327	1,743,327
Investments	5,717,766	—	—	5,717,766	5,717,766
Accounts receivable ^[1]	—	60,729	—	60,729	60,729
	<u>7,461,093</u>	<u>60,729</u>	<u>—</u>	<u>7,521,822</u>	<u>7,521,822</u>
Financial liabilities					
Accounts payable and accrued liabilities ^[2]	—	—	2,470,216	2,470,216	2,470,216
Convertible unsecured subordinated debentures	—	—	16,548,369	16,548,369	16,180,672
	<u>—</u>	<u>—</u>	<u>19,018,585</u>	<u>19,018,585</u>	<u>18,650,888</u>
2008					
Financial assets					
Cash and cash equivalents	2,187,423	—	—	2,187,423	2,187,423
Investments	18,934,737	—	—	18,934,737	18,934,737
Accounts receivable ^[1]	—	80,569	—	80,569	80,569
	<u>21,122,160</u>	<u>80,569</u>	<u>—</u>	<u>21,202,729</u>	<u>21,202,729</u>
Financial liabilities					
Accounts payable and accrued liabilities ^[2]	—	—	6,093,263	6,093,263	6,093,263
Convertible unsecured subordinated debentures	—	—	13,634,906	13,634,906	13,634,906
	<u>—</u>	<u>—</u>	<u>19,728,169</u>	<u>19,728,169</u>	<u>19,728,169</u>

[1] Excluding commodity taxes and withholding taxes

[2] Excluding certain reserves

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14. FINANCIAL INSTRUMENTS [Cont'd]

Fair value

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The Company uses the following methods and assumptions to establish the fair value for each class of financial instruments:

- **Available-for-sale**
Cash equivalents and investments – The fair value is determined using quoted market prices. Cash equivalents and investments were classified as available-for-sale due to their short-term nature and the fact that they must be readily available to finance the Company's operations.
- **Loans and receivables**
Accounts receivable – The carrying amount is a reasonable approximation of fair value due to the short-term nature of these financial assets.
- **Other financial liabilities**
Accounts payable and accrued liabilities – The carrying value of accounts payable and accrued liabilities is a reasonable approximation of the fair value due to the short-term nature of these financial liabilities.
Convertible unsecured subordinated debentures – The fair value of the debt component is calculated by using prevailing market rates for similar debt instruments.

Foreign currency risk

A substantial portion of the Company's expenses are incurred in US dollars. A significant change in the currency exchange rate between the Canadian dollar relative to the US dollar could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations. As at October 31, 2009, the Company is exposed to currency risk through its cash, accounts payable and accrued liabilities denominated in US dollars. As at October 31, 2009, US-denominated cash amounted to US\$28,790 [2008 – US\$233,414] and US-denominated accounts payable and accrued liabilities amounted to US\$963,642 [2008 – US\$3,432,188]. In addition, the Company is exposed to currency risk through accounts payable denominated in other foreign currencies, primarily, British Pounds and Swiss Francs.

Based on the above net exposures as at October 31, 2009, and assuming that all other variables remain constant, a 10% depreciation of the Canadian dollar or a 10% appreciation of the Canadian dollar against the US dollar would result in increases (decreases) in net loss of \$96,364 (\$96,364) and nil on comprehensive loss.

NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

14. FINANCIAL INSTRUMENTS [Cont'd]

Credit risk

The Company's cash and cash equivalents and short-term investments are mainly held through Canadian financial institutions. Cash equivalents are mainly investments in guaranteed investment certificates that are readily convertible into a known amount of cash, are subject to minimal risk of changes in value and have an original maturity of three months or less from the date of purchase. Short-term investments are mainly investments in guaranteed investment certificates that are readily convertible into a known amount of cash, are subject to minimal risk of changes in value and have an original maturity from three months to a year from the date of purchase. Short-term investments are all invested with large Canadian financial institutions.

The Company's maximum credit risk exposure corresponds to the carrying values of its cash, cash equivalents, short-term investments and accounts receivable.

Liquidity risk

The Company's investment policy is to invest its excess cash in high-grade investment securities with varying terms to maturity, selected with regards to the expected timing of expenditures for continuing operations. The convertible unsecured subordinated debentures mature on December 31, 2010 while accounts payable and accrued liabilities are all payable over the next 12 months.

Interest rate risk

Interest rate risk arises due to the Company's cash equivalents and investments being invested in fixed-rate securities with short-term maturities. Interest rate risk related to the convertible unsecured subordinate debentures is limited given that they are fixed-rate instruments.

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NOTES TO FINANCIAL STATEMENTS

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15. STATEMENTS OF CASH FLOWS

Cash and cash equivalents

Cash and cash equivalents consist of the following:

	2009	2008
	\$	\$
Cash on hand and bank balances	238,658	2,187,423
Cash equivalents	1,504,669	—
	<u>1,743,327</u>	<u>2,187,423</u>

Net changes in non-cash working capital balances related to operations

	2009	2008
	\$	\$
Accounts receivables and other assets	(927,026)	(57,367)
Investment tax credits receivable	18,000	627,000
Prepaid expenses	47,207	(20,061)
Accounts payable and accrued liabilities	(6,945,247)	1,504,205
Unearned revenues	—	(35,314)
	<u>(7,807,066)</u>	<u>2,018,463</u>

16. ACCUMULATED OTHER COMPREHENSIVE LOSS

Investments classified as available-for-sale constitute the sole item affecting “accumulated other comprehensive loss”. The changes that occurred during the years ended October 31, 2009 and 2008 were as follows:

	2009	2008
	\$	\$
Balance, beginning of year	(71,657)	(15,333)
Changes to unrealized gain (loss) on investments	72,337	(56,324)
Balance, end of year	<u>680</u>	<u>(71,657)</u>

17. COMPARATIVE FIGURES

Certain of the 2008 figures have been reclassified in order to conform with the presentation adopted in 2009.