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THE POWER  
OF LIGHT**

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Healing at the Speed of Light<sup>®</sup>

## **Management's Discussion and Analysis of Financial Condition and Operations**

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The following Management Discussion and Analysis ("MD&A"), of **Theralase Technologies Inc.** (the "Company" or "Theralase") should be read in conjunction with the Company's interim consolidated financial statements for the six-months ended June 30, 2010. This MD&A has been filed in accordance with the provisions of National Instrument 51-102 (*Continuous Disclosure Regulation*). Copies of the further relevant financial documents and earlier corporate filings to date, may also be referenced on the regulatory website - SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A is prepared as of August 30, 2010.

The Company's common shares are listed for trading on the TSX Venture Exchange (**Symbol: TLT**).

### **Forward Looking Statements**

*Certain statements contained or incorporated in this MD&A which deal with the Company's financial condition and operating results, include information, analyses and projections as to future corporate developments which are currently in the planning stage, and on the projected operating financial performance of the Company, which constitute forward-looking statements. Such forward-looking statements, made with special reference to the Company's ongoing technologically complex healthcare and medical device research and development efforts, which may include in-house and independent clinical trials, testing new medical technologies and their applications, involve known and unknown risks and uncertainties that could cause actual events and results to differ materially from those estimated or anticipated and which may have been implied or expressed in such forward-looking statements. No conclusions as to the successful outcome of the ongoing and planned research and development projects in which the Company is involved are intended or implied nor can they be foreseen or predicted prior to definitive corporate announcements as to their outcome.*

*Furthermore, the forward-looking statements contained in this MD&A are made as of the date hereof and the Company does not undertake any obligations to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

### **Company Profile**

Theralase designs, develops and manufactures patented, super-pulsed laser technology utilized in bio-stimulation and bio-destruction applications. The technology is safe and effective in the treatment of chronic pain, neural muscular skeletal conditions and wound care. When combined with light-sensitive Photo Dynamic Compounds, Theralase laser technology is able to specifically target and destroy cancers, bacteria and viruses.

Theralase is focused on a two-part strategy:

1. Production, marketing and distribution of the Theralase Super-Pulsed Laser for sale to health care practitioners focused on the treatment of chronic pain, sports injuries and wounds.
2. Commercialization of patented cancer treatment through progressive research, clinical trials and advancement of new technology in the direct destruction of cancers.

### **Advancing the Theralase Technology Platform**

The following summarizes several material, technical and business developments that management considers will fuel and accelerate near and longer term Company growth:

#### **TLC-2000: Biofeedback Laser Technology**

Theralase continues to make progress on commercializing its next generation therapeutic laser – the patented TLC-2000. The TLC-2000 biofeedback technology targets tissue at depth with higher precision than its competitors enabling exact

doses of energy to be delivered to injured tissue for enhanced efficacy and accelerated healing. The TLC-2000 is also a learning device that remembers the most optimized protocols based on individual patient's optical tissue profiles.

In 2Q2010, Theralase continued development of the beta prototype of the TLC-2000 biofeedback therapeutic laser system, which will lead to the final prototype prior to commercialization. Theralase is currently conducting clinical trials of the technology at the University of Buffalo (Buffalo, New York) to demonstrate the efficacy of the TLC-2000 in the areas of myofascial pain. These clinical studies, if proven successful, could secure a new Current Procedural Terminology (CPT) code for reimbursement of laser treatments in the US. Theralase expects to start selling the TLC-2000 in the first quarter of 2011.

### **TLC-3000: Cancer Therapy**

The proprietary TLC-3000 medical laser system has been custom designed by Theralase for the activation of Theralase's patented Photo Dynamic Compounds (PDCs), aimed for the destruction of cancer cell lines. In 2009, in vitro experiments conducted at the Ontario Cancer Institute at Princess Margaret Hospital demonstrated complete destruction of brain tumour cells (9L) following administration of the Company's patented PDCs and subsequent activation with the Company's TLC-3000 light source. In early 2010, the Ontario Cancer Institute at Princess Margaret Hospital demonstrated complete destruction of breast cancer cells following administration of the Company's patented PDCs and subsequent activation with the Company's TLC-3000 light source. This completes Milestone 1 of the cancer research project, which is the successful destruction of cancer cell lines in vitro.

Lothar Lilge Ph.D., lead researcher on the project stated, "I am excited about the possibilities and opportunities that these PDCs present in the destruction of cancer cells. An oxygen independent reaction is unique for this type of cancer therapy, where low oxygen conditions pose a major problem. The ability to completely destroy cancer cells in the absence of oxygen presents the opportunity of treating solid tumours of the breast, prostate, lung and brain, to name a few."

The Company commenced Milestone 2 in 2Q2010, which is the evaluation of a variety of cancer cell lines in an in vivo small animal model, most notably focusing on breast cancer and prostate cancer. This research, if proven successful, will lay the groundwork for the dose of the PDC and the amount of laser light required to successfully activate the PDCs in cancer destruction in both larger companion animals and in humans.

Successful achievements in its current research will enable Theralase to commence Milestone 3, which is the treatment of cancer in cats and dogs. One in eight pet animals develop cancer in their lifetimes. This presents a significant opportunity for the Company.

The Theralase PDC research and development initiative is also jointly funded with the Ontario Centres of Excellence's (OCE's) Centre of Excellence for Photonics.

### **Medical and Scientific Advisory Board (MSAB) Addition**

Dr. Terry Ruch DVM, renowned veterinarian to the equine market, has agreed to join Theralase's MSAB in the capacity of equine medical consultant. Dr. Ruch is a graduate of the University of Guelph (1974) and has devoted his practice to equine medicine – focusing on the diagnostic and orthopaedic examination of equine athletes. Dr. Ruch has been deeply involved with equine sports medicine for the past 36 years and is highly regarded in his field.

Dr. Ruch brings to the MSAB a wealth of experience, expertise and knowledge in equine medicine that will complement our already distinguished board, who are medical experts in human orthopaedic and rehabilitative medicine. We are excited about what Dr. Ruch will contribute to Theralase, particularly as it relates to research and new clinical applications of the Theralase technology in the equine market. Dr. Ruch's addition to the MSAB allows Theralase the opportunity to expand the use of our Theralase laser technology into the equine marketplace, creating a new source of revenue for the company.

## Overview of Financial Performance

During the year ended under review, the Company's financial performance and its operating results reflected investment in research and development initiatives, production ramp-up and sales of the Theralase therapeutic laser system.

## Summary of Selected Annual Information

Year ending December 31	2009	2008	2007
Total revenues	2,359,855	2,168,411	1,559,850
Net profit / (loss)	(241,578)	(1,111,675)	(1,113,373)
Basic and diluted loss per share	\$ (0.01)	\$ (0.03)	\$ (0.03)
Total assets	4,190,841	3,181,538	3,707,277
Total liabilities	703,900	794,786	335,122
Deficit	(7,797,524)	(7,555,946)	(6,444,271)
Shareholders' Equity	3,486,941	2,386,752	3,372,155

## Summary of Quarterly Results

	2010		2009	
	June 30	March 31	December 31	September 30
Total revenues	640,270	462,081	768,210	501,263
Net profit / (loss)	(198,533)	(276,186)	89,001	(87,164)
Basic and diluted loss per share	\$ (0.01)	\$ (0.01)	\$ 0.00	\$ (0.00)
Total assets	3,720,479	3,835,399	4,190,841	2,865,647
Total liabilities	550,502	544,179	703,900	744,404
Deficit	(8,272,243)	(8,073,710)	(7,797,524)	(7,887,716)
Shareholders' Equity	3,169,977	3,291,220	3,486,941	2,121,243
	2009		2008	
	June 30	March 31	December 31	September 30
Total revenues	629,004	461,378	779,600	459,789
Net profit / (loss)	(27,356)	(217,250)	(308,395)	(240,751)
Basic and diluted loss per share	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Total assets	3,029,982	2,980,349	3,181,538	3,233,543
Total liabilities	827,240	779,585	794,786	534,884
Deficit	(7,800,552)	(7,773,196)	(7,555,946)	(7,247,551)
Shareholders' Equity	2,202,742	2,200,764	2,386,752	2,698,659

## Liquidity and Capital Resources

As at June 30, 2010, current assets aggregated to \$1,557,601 compared with current liabilities of \$458,698 netting a working capital position of \$1,098,903 and a current ratio (current assets vs. current liabilities) of approximately 3.4:1.

The Company's objective is to maintain a sufficient capital base so as to sustain future research and development and business initiatives and to maintain investor, creditor and market confidence. The Company makes every attempt to manage its liquidity to minimize shareholder dilution where possible.

The Company has a revolving line of credit, repayable on demand, which bears interest at the bank's prime rate plus 2%. It is secured by a general security agreement registered against the Company and its Canadian subsidiary. As at June 30, 2010, there are no amounts drawn on this line of credit.

As at June 30, 2010, the Company had cash and cash equivalents on hand of \$813,518. Sales of the TLC-1000, the Company's existing product line, have not been sufficient in and of themselves to enable the Company to fund all its continuing development and commercialization efforts and, accordingly, management is pursuing alternate financing sources to fund the Company's development and commercialization efforts. Similar to the financing secured through the oversubscribed private placement that took place on November 26, 2009, management believes that the Company will be able to secure the necessary financing through a combination of; the issue of new equity or debt instruments, entering into joint venture arrangements and/or strategic alliances. Nevertheless, there is no assurance that these initiatives will be successful.

## Results of Operations

For the six-month period ended June 30, 2010 revenue increased to \$1,102,351, compared to \$1,090,382 for the same period in 2009.

	<b>Six Months Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Sales Revenue	\$ 1,008,437	\$ 1,006,461
Service Revenue	34,882	23,661
Clinic Revenue	8,075	16,687
Other Revenue	50,957	43,573
	<b>1,102,351</b>	<b>1,090,382</b>

Revenue for the six-month period ended June 30 decreased in Canada by 30% to \$653,423 in 2010 from \$934,070 in 2009 and slightly decreased in the US by 4% to \$127,009 in 2010 from \$131,833 in 2009. International sales for the six-month period ended June 30 increased 1,215% to \$321,920 in 2010 from \$24,279 in 2009. The strong growth in international product sales is a reflection of the Company expansion of its sales and marketing initiatives to penetrate untapped aspects of emerging international markets. The weak US economy and record unemployment rate in the US market has factored into the modest decrease in American product sales. However, the significant decrease in Canadian product sales is not an indication of poor market conditions, but more of a reflection of the company redirecting resources to intensify its efforts to better penetrate the US market, a market for which it has experienced a challenging environment over the past several quarters. The Company has established and is further evaluating augmenting its direct sales force with leading US, Canadian and International healthcare product distributors to market its products in the US, Canadian and International markets respectively.

### Cost of sales

Cost of sales for the six-month period ended June 30, 2010 was \$378,771, resulting in a gross profit of \$723,580 or 66% of revenue, compared with \$720,153 or 66% of revenue for the same period in 2009. Cost of sales is represented by the following costs: raw materials, sub-contracting, direct and indirect labour and the applicable share of manufacturing overhead.

### Operating Expenses

Selling expenses for the six-month period ended June 30, 2010 were \$273,675, representing 25% of sales, compared with \$233,476 or 21% of product sales for the same period in 2009. The percentage increase as a percentage of sales is a reflection of higher selling expenses for additional staffing, increases in travel and advertising expenses.

Administrative expenses for the six-month period ended June 30, 2010 were \$659,480, representing a 23% increase from \$535,063 reported for the same period in 2009, and consisted of the following items:

	<b>Six Months Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Insurance	22,183	27,672
Professional Fees	51,582	48,419
Rent	53,791	53,791
Other	43,342	55,373
Compensation	341,739	271,755
Advisory	12,551	22,251
Stock Based	134,292	55,802
	<b>659,480</b>	<b>535,063</b>

Administrative expenses for the six-month period ended June 30, 2010 are attributed to the following:

- Insurance expense decreased 20% as a result of obtaining more competitive premiums for required coverage.
- Professional fees increased by 7% due to higher audit and accounting fees billed in the prior year, and higher accrued costs for the current fiscal year's audit which will involve the adaptation of International financial reporting standards (IFRS).
- Compensation expense increased 26% due to the addition of administrative and marketing personnel.
- Stock based compensation increased 141% due to the increase in outstanding stock options.

#### Research and Development Costs

Gross Research and Development costs expensed totaled \$200,873 for the six-months ended June 30, 2010, compared to \$107,552 in 2009. This represents an 87% increase attributable to increased expenditures on the TLC-2000 biofeedback laser and TLC-3000 Photo Dynamic Compounds development.

#### **Net Profit (Loss)**

The net loss for the six-month period ended June 30, 2010 was \$474,719, which included \$196,444 of non-cash expenses (amortization, stock-based compensation expense, foreign exchange gain/loss and lease inducements). This compares to a net loss for the same period in 2009 of \$244,606 which included \$152,576 of non-cash expenses. The Company expends the future product development costs of the TLC-2000 Biofeedback Therapeutic Laser and TLC-3000 Photo Dynamic Compounds from existing TLC-1000 Therapeutic Laser product sales, resulting in an overall net loss.

#### **Cash Flows**

Funds used in operating activities for the six-month period ended in June 30, 2010 amounted to \$343,303 compared to \$110,380 for 2009. The increase is primarily as a result of increased compensation expenses for additional personnel, increased travel and advertising expenses to more effectively penetrate the US market.

Funds used in investing for the six-month period ended in June 30, 2010 amounted to \$47,223 compared to \$5,232 in 2009, increasing primarily as a result of infrastructure for increased personnel and in-house marketing initiatives. Capital expenditures for the six-month period ended in June 30, 2010 were primarily related to the acquisition of office equipment, patents and licensing fees for the Photo Dynamic Compounds.

For the six-month period ended June 30, 2010, funds obtained from financing activities amounted to \$16,940 compared to \$111,452 in funds obtained through financing activities in 2009. The funds generated in 2010 were primarily as a result of the exercising of common share purchase warrants, whereas the funds generated in 2009 were from the company's revolving line of credit for short-term financing requirements.

## Assets (other than Cash and Equivalents)

The Company holds essential and valuable intellectual property rights and assets, including patents, trademarks, development and related costs. The depreciated book value of these assets is \$191,952 to which is added \$1,861,078 in goodwill. Management considers that the value of the Company's intellectual and related property rights and assets is significantly higher than its carrying amount.

Goodwill is not subject to amortization but is assessed for impairment on at least an annual basis and, additionally, whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested by comparing the carrying amount of net assets, including goodwill, to the fair value of net assets. Fair value is estimated using the discounted cash flow approach. If the carrying amount of net assets exceeds its fair value, then a second step is performed to quantify the amount of the impairment loss, if any. Any impairment in the carrying value of goodwill is recognized in operating income.

In 2009, the Company performed the annual impairment test and determined there was no impairment in goodwill.

## Commitments

As of June 30, 2010, the Company's commitments consist of the following:

	2010	2011	2012	Total
Lease obligations (a)	\$ 26,664	\$ 53,873	\$ 31,426	\$ 111,962
Research commitments (b)	108,824	56,776	-	165,600
<b>Total</b>	<b>\$ 135,488</b>	<b>\$ 110,649</b>	<b>\$ 31,426</b>	<b>\$ 277,562</b>

- i) Lease obligations under a lease agreement related to its premises which commenced on August 1, 2007 and expires on July 31, 2012. Under the terms of this lease, the Company is required to pay a proportionate share of operating costs, realty taxes and utilities, in addition to the minimum rental payments. The future minimum lease payments are shown in the table above.
- ii) Research commitments under a research collaboration agreement with Virginia Polytechnic Institute and State University for the TLC-3000 cancer therapy project. Under the terms of this agreement, the company is required to pay \$266,597 for the period from September 2009 through May 2011. During 2009 the company incurred billings amounting to \$43,390 relating to this commitment, of which \$43,390 was paid under this agreement. For the six months ended June 30, 2010, the company incurred \$57,607 in expenses related to this commitment, of \$nil was paid under this agreement.

The Company indemnifies its directors and officers against any and all costs, charges and expenses, including settlements of claims in respect of any civil, criminal or administrative action incurred in the performance of their service to the Company to the extent permitted by law. The Company maintains liability insurance for its officers and directors.

## Share Capital Analysis

As at June 30, 2010 and at the date of this MD&A, the share capital of the Company consisted of 39,220,475 common shares. Each common share entitles the holder to one vote per share. At June 30, 2010, there were 3,150,000 options outstanding, of which 2,483,332 were vested and exercisable into an equivalent number of the Company's common shares as follows:

Options Exercisable	Weighted Average Exercise Price
2,416,666	\$ 0.60
33,333	\$ 0.10
33,333	\$ 0.15
<b>2,483,332</b>	

To the knowledge of the Directors and senior officers of the Corporation as of June 30, 2010, the only person or persons or companies beneficially owning or controlling, directly or indirectly, common shares carrying more than ten percent (10%) of the voting rights attached to all common shares of the Corporation is Roger Dumoulin-White, who directly holds 4,841,806 (12%) of the outstanding common shares of the Corporation (not including 247,756 shares held by his spouse, Kristina Hachey, over which shares Mr. Dumoulin-White disclaims any beneficial interest or control), and S. Donald Moore, who directly holds 1,028,430 common shares, and indirectly holds 10,743,025 common shares through his associate, Talent Oil and Gas Ltd., and effectively controls, or exercises direction over, an aggregate of 11,771,455 (30%) of the outstanding common shares of the Corporation.

On November 26<sup>th</sup>, 2009, the Company closed a non-brokered private placement which raised gross proceeds of \$1,270,750 by issuing 4,235,833 units to investors at a price of \$0.30 per unit. Each unit consists of 1 common share and a ½ of a non-transferable common share purchase warrant. Each whole warrant entitles the holder thereof to purchase 1 additional common share at a price of \$0.45, until November 26<sup>th</sup>, 2011.

### **Segmented Information**

The statements and projections herein are understood to be limited to one reportable operating segment which, for the purposes of this MD&A, comprises the manufacturing and sales of the Company's therapeutic medical laser equipment, largely in the North American market, without any differentiation as to geographic areas or locations.

### **Selected Financial Information and Accounting Policies**

The Consolidated Financial Statements for the six-month period ended June 30, 2010, and all other Financial Statements referred to herein, have been prepared in accordance with Canadian generally accepted accounting principles (GAAP), consistently applied, and all amounts and currencies reported therein, and in this MD&A, are in Canadian dollars, unless otherwise noted. The ongoing accounting policies are more particularly described in the Notes to the unaudited Consolidated Financial Statements for the six-month period ended June 30, 2010. Please refer to the Company's historic annual and quarterly financial statement filings, including material interim Press Releases, on the regulatory website -- [www.SEDAR.com](http://www.SEDAR.com).

### **Use of Financial Instruments**

The Company's financial instruments consists of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The fair values of cash, accounts receivable, accounts payable and accrued liabilities approximate carrying value because of the short-term nature of these instruments.

(i) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counter-party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's accounts receivable. The amounts reported in the balance sheet are net of allowances for bad debts, estimated by the Company's management based on prior experience and their assessment of the current economic environment. The Company reviews its trade receivable accounts regularly and reduces amounts to their expected realizable values by adjusting the allowance for doubtful accounts as soon as the account is determined not to be fully collectible. The Company has adopted credit policies in an effort to minimize those risks.

Cash equivalents are held in high-grade, bankers' acceptance and other low risk investments with no exposure to liquidity or other risk associated with Asset-Backed Securities. These financial instruments are classified as held for trading as they may periodically be traded before their maturity date. However, the majority of these financial instruments are classified as held to maturity and would not result in a significant risk of fair value changes if held to maturity. At June 30, 2010 the balance of investments held was \$nil.

(ii) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk by continuously monitoring forecasted and actual cash flows, as well as anticipated investing and financing activities. The Company does not have long-term financial liabilities.

(iii) Interest rate risk:

Interest rate risk is the risk that changes in interest rates will affect the Company's income or the value of the financial instruments held. The Company is subject to interest rate risk on its cash and short-term investments; however, it does not expect a movement in the interest rate to have a significant impact on the company's financial position..

(iv) Foreign currency exchange risk:

The Company's primary risks are exposure to foreign currency exchange risk. These risks arise from the Company's holdings of US and Canadian dollar denominated cash, accounts receivable and accounts payable. Changes arising from these risks could impact the Company's reported foreign exchange gains or losses. The Company limits its exposure to foreign currency risk by holding US denominated cash in amounts of up to 100% of forecasted twelve month US dollar expenditures, thereby creating a natural hedge against foreign currency fluctuations and limiting foreign currency risk to translation of US dollar balances at the balance sheet date.

The Company has not entered into any conventional or other financial instruments designed to minimize its investment risk, currency risk or commodity risk. No off-balance sheet arrangements have been established nor are there any pending proposals or indicated business requirements to this effect.

#### **Future accounting pronouncements**

The Company reviews all changes to the CICA Handbook when issued. The following will become effective after June 30, 2010:

- The CICA issued three new accounting standards in January 2009: Section 1582, *Business Combinations*, Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-controlling Interests*. The Company is in the process of evaluating the requirements of the new standards. Section 1582 establishes standards for the accounting for a business combination. It provides the Canadian equivalent to IFRS 3 — *Business Combinations*. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 and early application is permitted. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements. It is equivalent to the corresponding provisions of IFRS IAS 27 — *Consolidated and Separate Financial Statements*, Sections 1601 and 1602, and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011 and early application is permitted.
- CICA Handbook EIC 175, *Multiple Deliverable Revenue Arrangements*, replaces EIC 142, *Revenue Arrangements with Multiple Deliverables*. This abstract was amended to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated. The abstract requires, in situations where a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method; and requires expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted.

#### **Conversion to International Financial Reporting Standards**

Canada's Accounting Standards Board (AcSB) has announced that, effective January 1, 2011, International Financial Reporting Standards (IFRS) will replace the current Canadian GAAP for publicly accountable enterprises. Financial reporting under IFRS differs from Canadian GAAP in a number of respects, some of which are significant. Commencing in

fiscal 2010, the Company is preparing accounts in accordance with Canadian GAAP and IFRS in order to have comparative financial statements upon full implementation of IFRS in 2011. The Company commenced its IFRS conversion project in 2009.

The IFRS conversion project has three primary phases as follows:

- **Phase one**, high-level assessment to identify key areas that may be impacted by the transition to IFRS, and ranking these as high, medium or low priority, as well as the creation of a formalized project plan including key milestones and timelines, resources required, education and training requirements. Phase one of the project was completed in 2Q 2010.
- **Phase two**, each area identified from Phase one will be addressed by performing an in depth analysis of differences between the current Canadian GAAP and IFRS, evaluation and selection of available accounting policies, quantification of impacts and development of draft IFRS financial statement contents. This phase also includes the identification of operational impacts such as information technology, process and internal control changes. Phase two of the project has commenced and is scheduled for completion by the end of 3Q2010
- **Phase three**, the Company will integrate the new accounting policies and operational impacts into the Companies underlying information systems and business processes. Phase three of the project is scheduled for completion in 4Q2010

The following section sets out the Company's preliminary potential IFRS policy decisions and significant accounting differences, based on the analysis of the current IFRS standards. Theralase has further investigated and quantified these policy choices during the first half of 2010. During phase 2 of this process, additional differences between Canadian GAAP and IFRS may be identified. As a result, these accounting policy choices may change prior to the adoption of IFRS on January 1, 2011. Although Theralase has identified key accounting policy differences, the impact of these differences to Theralase's consolidated financial statements has not been determined at this time. Decisions with respect to accounting policy changes, outlined below, may change once management has quantified and thoroughly analyzed the effects of such changes and has presented them for final review and approval by the Audit Committee.

As a first time adaptor of IFRS, the Company is allowed to elect certain exemptions under IFRS 1 from a full retrospective application of IFRS. IFRS 1 has certain mandatory exceptions as well as limited optional exemptions. Based on a preliminary analysis to date, Theralase is currently investigating the following optional exemptions available under IFRS 1 that will be significant to the Company in preparing its consolidated financial statements under IFRS:

- **Business combinations** – IFRS 1 allows companies to have the option not to apply IFRS 3 (Revised) Business Combinations (IFRS 3(R)) retrospectively. The Company is currently assessing and quantifying the application of IFRS 3 (revised), Business combinations, for all business combinations completed after January 1, 2003.
- **Share Based Payment Transactions (High Impact)** IFRS 2, *Share-based payments*, encourages entities to apply the standard to all equity instruments issued, however under IFRS 1 the Company may elect not to apply IFRS 2 to equity instruments issued prior to November 7, 2002, and to equity instruments issued after November 7, 2002 that were vested prior to the date of transition. The Company will make this election and apply IFRS 2 only to equity instruments that were issued after November 7, 2002 that had not vested prior to January 1, 2010. IFRS 2 will apply to the Company's share options that were granted after November 7, 2002, but have not vested prior to January 1, 2010, as noted above.

In addition to the IFRS 1 exceptions and exemptions, the following are the preliminary assessments of key differences between the Company's Canadian GAAP accounting policies and those under IFRS.

- **Impairment of long-lived assets and goodwill** – Canadian GAAP uses a two-step approach to assess long-lived assets while, under IFRS, impairment testing is a one-step process. IFRS requires long-lived assets and goodwill to be tested at the level of the cash-generating unit (CGU), the smallest group of assets that generates cash inflows from continuing use that largely are independent of the cash inflows of other assets or groups thereof.

Under Canadian GAAP, an asset group is the lowest level for which there are identifiable cash flows that largely are independent of the cash flows of other groups of assets. As a result, there is a higher probability that an impairment loss is recognized under IFRS. In addition, Canadian GAAP does not allow any impairment losses for assets to be reversed while under IFRS, if certain criteria are met, reversal is required, other than goodwill. Therefore detailed documentation of impairment is needed under IFRS for future potential reversal.

- **Intangible Assets and Goodwill (IAS38)** – An intangible asset is an identifiable non-monetary asset without physical substance. An intangible asset is recognised when its cost is reliably measurable and it is probable that future economic benefits attributable to the asset will be realised. Under Canadian GAAP, intangible assets may not be revalued to fair value and certain relocation or restructuring costs following a business combination are capitalised. Under IFRS intangible assets may be revalued to fair value if there is an active market and expenditure on relocation or reorganisation is expensed as incurred. As well, the criteria of when to test for impairment are also more stringent under IFRS vs Gaap. The Company does not foresee any changes due to these IFRS guidelines
- **Income taxes** – Under Canadian GAAP, if additional deferred tax assets that were not recognized at the date of acquisition are realized subsequently, then the adjustment is recognized first against goodwill, then against intangible assets, before any adjustment is recognized as a tax recovery in profit or loss. Under IFRS, such adjustment is recognized directly in profit or loss. The recognition of deferred income taxes for temporary differences arising from intercompany transfer of property is prohibited under Canadian GAAP while there are no similar exceptions under IFRS. Other significant differences may impact the company such as accounting for uncertain tax positions, backwards tracing, and differences relating to presentation and disclosure.
- **Revenue Recognition (IAS18)** - Under Canadian GAAP Identifiable components of a multiple deliverable revenue arrangement may be considered to be separate units of accounting. Under IFRS in a multiple deliverable arrangement, revenue is recognized on an element of a transaction if that element has commercial substance on its own; otherwise the separable elements must be linked and accounted for as a single transaction.

The Company has multiple deliverable arrangements in the form of extended warranty. Currently extended warranty is separated from the sale of the unit and deferred over the life of the warranty. The Company does not foresee any differences to the way in which it accounts for extended warranty sales under IFRS.

- **Property, Plant and Equipment (“Fixed assets”) (IAS 16)** - Under Canadian GAAP the historical cost model is for valuing Fixed Assets is required. Fixed Assets are to be recorded at cost upon initial acquisition and are to be depreciated over their useful lives. Although GAAP does incorporate the componentization concept it may not be applied as rigorously in Canada. Review of useful life and residual values is required to be done on a regular basis but ‘regular’ is not defined.

Under IFRS, after initial recognition, there is the option to measure fixed assets using the cost model or the revaluation (mark-to-fair-market value) model. Fixed assets must be recognized, derecognized and depreciated at a component level. Useful life and residual values used are to be reviewed at least annually. The Company has determined that it will continue to use the historical cost model and the other IFRS requirements will not significantly impact the financial statements.

- **Provisions and Contingencies (IAS 37)** - Under Canadian GAAP a provision should be recorded when management believes the obligation is probable (>75%) and can be reasonably estimated. Under IFRS a provision should be recorded if an obligation is probable (>50%). The amount recognized as a provision must be the best estimate of expenditures required to settle the present obligation at the balance sheet date. The Company does not expect any material changes to its accrued liabilities based on the current IFRS guidelines.
- **The Effects of Changes in Foreign Exchange Rates (IAS 21)** - Canadian GAAP assessment of an entity’s functional currency is not explicitly required. Under IFRS an entity must measure its assets, liabilities, revenues and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. The assessment entails consideration of primary and secondary factors, if needed. The assessment by management is that the functional currency will not change under IFRS.

- **Leases (IAS17)** - Canadian GAAP has fewer qualitative indicators but also provides numeric thresholds that are used as bright lines to classify a lease as operating or capital. IFRS does not consider the Canadian bright line tests but relies on a judgmental assessment of substance of the transaction when determining the type of lease. The Company does not believe that the classification of its leases will change under IFRS however the guidance is changing in this area. The Company will need to evaluate this new guidance especially in the area of sales-type leases carefully once complete.
- **Trade receivables (IFRS7)** - Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. Under Canadian GAAP trade receivables are classified as current however under IFRS if collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as noncurrent assets. As well, trade receivables are recognised initially at fair value and subsequently measured at amortised using the effective interest method. The company is already breaking out the current and non-current portion of trade receivables every quarter in parallel.
- **Trade payables (IFRS7)** - Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Under Canadian GAAP trade payables are classified as current. Under IFRS, accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer) if not, they are presented as non-current liabilities. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. The company is already breaking out the current and non-current portion of trade payables every quarter in parallel.

As IFRS evolves during the transition period, the impact of IFRS on the Company will also evolve. It may result in additional accounting changes, some of which may be significant. The Company will continue to monitor any changes to IFRS prior to January 1, 2011, assess the impact of adopting IFRS, and update its MD&A disclosures quarterly in order to report on the progress of its IFRS transition plan.

### **Disclosure Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures as at and for the three-month period ended June 30, 2010. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of the Company's disclosure controls and procedures were effective as at June 30, 2010 to provide reasonable assurance that material information relating to the Company would be made known to them by others and information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation.

### **Internal Control over Financial Reporting**

As at June 30, 2010, an evaluation of the effectiveness of internal controls over financial reporting, as defined in the rules of the SEC and Canadian Securities Administrators, was carried out to provide reasonable assurance regarding the reliability of financial reporting and financial statement compliance with GAAP. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting of the Company were effective and provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

All control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention or overriding of the controls or procedures. As a result, there is no certainty that our disclosure controls and procedures or internal control over financial reporting will prevent all errors or all fraud.

The following changes in the Company's internal control over financial reporting have occurred as of June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting:

- Dual signature requirements on all cheques
- Improved segregation of duties
- Increased and regular reviews of financial reporting schedules

As the Company incurs future growth, the Company plans to continue to expand the number of individuals and the technical competence of the individuals involved in the accounting function.

With the implementation of the above corrective actions, the Company believes that the above noted actions addressed the material weaknesses that were identified in its internal control over financial reporting in 2009.

## **Risks and Uncertainties**

The Company's operations involve certain risks and uncertainties that are inherent to the Company's industry. The most significant known risks and uncertainties faced by the Company are described below.

### Capital Resources

In order to achieve its long term development and commercialization strategy for the Company's range of biomedical laser systems and photodynamic compounds, the Company will need to raise additional capital through the issuance of shares, collaboration agreements or partnerships that would allow the Company to finance its activities. Nothing guarantees that additional funds will be available or that they may be acquired according to acceptable terms and conditions. Additional financing may result in dilution of shareholder value.

### Volatility of Share Price

The market price of the Company's shares is subject to volatility. General market conditions as well as differences between the Company's financial, scientific and clinical results and the expectations of investors as well as securities analysts can have a significant impact on the trading price of the Company's shares.

### Regulatory Approvals

The Company is directly and indirectly engaged in the design, manufacture, sale and marketing of biomedical laser equipment, a category of medical device which is subject to regulatory oversights, audits and controls by various national regulatory agencies (FDA, Health Canada, CE) and authoritative quality standards bodies (UL, CSA, ISO and TUV), all with strict quality certification procedures. The Company is in full compliance with all the governing regulatory and quality standards approval requirements pertaining to the medical laser devices it currently designs, manufactures and markets. No assurance can be given that current regulations relating to regulatory approval will not change or become more stringent and it must be noted that product approvals may be withdrawn if compliance with regulatory standards is not maintained.

### Licenses and Patents

The Company's success will depend in part on its ability to obtain licenses and patents, protect its trade secrets and operate without infringing the exclusive rights of other parties. There is no guarantee that any license and patent that will be granted to the Company will bring any competitive advantage to the Company, that its license and patent protection will not be contested by third parties, or that the licenses and patents of competitors will not be detrimental to the Company's commercial activities. It cannot be assured that competitors will not independently develop products similar to the Company's products, that they will not imitate the Company's products or that they will not circumvent or invalidate licenses and patents granted to the Company.

### Currency Risk

The Company is exposed to currency risk through export sales, primarily in US dollars. Changes in exchange rates may result in foreign exchange gains or losses. The Company does not use derivative instruments to reduce its exposure to foreign currency risk and does not anticipate using any hedging strategies in a material way in the immediate future. Management will continue to assess the situation and may, as a result, change its approach to hedging foreign exchange currency fluctuations.

### Credit Risk

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, cash equivalents and accounts receivable. Cash and cash equivalents are in place with major financial institutions. The Company, in the normal course of business, is exposed to credit risk from its customers substantially all of whom are in the medical industry. These accounts receivable are subject to normal industry credit risks. The Company manages its credit risk through its credit evaluation, approval and monitoring processes.

### Human Resources

The Company's success is dependent upon its ability to attract and retain a highly qualified work force, and to establish and maintain close relationships with research centers. Competition is intense and the Company's success will depend, to a great extent, on its senior executives, scientific staff, and collaborators. The loss of key personnel could compromise the rhythm and success of product development.

### Product Liability

The Company has obtained product liability insurance coverage in the total amount of \$1,000,000. These insurance coverages are a limited guarantee and a product liability claim could potentially be greater than these coverages. The Company's profitability would be adversely affected by a successful product liability claim in excess of its insurance coverage.

### **Outlook**

The Company will focus on increasing product sales and market acceptance of the TLC-1000 laser technology in the Canadian and US market in the second half of 2010, supported by new independent scientific research confirming a higher effectiveness of the Company's proprietary technology over other competitive technologies. The Company will continue to invest in scientific research aimed at unlocking the mechanisms of action of how laser light can so dramatically heal tissue.

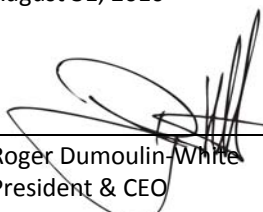
The Company will continue to commercialize its patented next generation TLC-2000 biofeedback technology for launch in the first quarter of 2011, while researching and developing its patented TLC-3000 photodynamic compound technology aimed at the destruction of cancer, bacteria and viruses.

The Company is well financed to execute on its strategic initiatives in 2010, but due to the on-going requirement of capital to fund the Company's growth in 2011 and beyond, the Company will continually investigate financing options – on both the debt and the equity side in order to achieve its strategic initiatives.

One of the Company's primary focuses for 2010 and beyond is to increase share liquidity, thus allowing shareholders the opportunity to participate in the Company's growth on their specific investing terms.

The Company feels that these initiatives will increase shareholder value as the Company achieves its strategic objectives.

August 31, 2010



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Roger Dumoulin-White  
President & CEO

# THERALASE® TECHNOLOGIES INC.

Consolidated Balance Sheets

As at June 30, 2010 and December 31, 2009

Stated in Canadian Dollars

	2010	2009
<b>Assets</b>		
Current assets		
Cash and cash equivalents (note 4)	\$ 813,518	\$ 1,187,104
Accounts receivable	511,116	563,556
Inventory	182,937	200,413
Prepaid expenses and other assets	50,030	50,831
Total current assets	1,557,601	2,001,904
Property and equipment	109,848	105,533
Intangibles	191,952	222,326
Goodwill	1,861,078	1,861,078
	<b>\$ 3,720,479</b>	<b>\$ 4,190,841</b>
<b>Liabilities</b>		
Current liabilities		
Bank Loan (note 3)	\$ -	\$ -
Accounts payable and accrued liabilities	439,992	561,422
Capital Lease obligation, current	3,696	6,876
Deferred revenue, current	15,010	28,444
Total current liabilities	458,698	596,742
Capital Lease obligation	12,604	11,234
Deferred revenue	48,523	59,452
Leasehold inducement	30,677	36,472
Total liabilities	550,502	703,900
<b>Shareholders' Equity</b>		
Share capital (note 4)	8,009,752	7,980,159
Common Share purchase warrants (note 4)	346,879	354,909
Contributed surplus (note 5)	3,085,589	2,949,397
Deficit	(8,272,243)	(7,797,524)
	<b>3,169,977</b>	<b>3,486,941</b>
	<b>\$ 3,720,479</b>	<b>\$ 4,190,841</b>

Approved on Behalf of the Board

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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

# THERALASE® TECHNOLOGIES INC.

Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the six and three-month period ended June 30

Stated in Canadian Dollars

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	2010	2009
Sales	\$ 640,270	\$ 629,004	\$ 1,102,351	\$ 1,090,382
Cost of Sales	206,759	198,880	378,771	370,229
Gross Margin	433,511	430,124	723,580	720,153
<b>Operating Expenses</b>				
Selling	161,594	113,837	273,675	233,476
Administrative	308,500	268,546	659,480	535,064
Research and development	133,109	34,057	200,873	107,552
Amortization of property and equipment	8,309	8,400	16,388	16,871
Amortization of intangibles	28,551	36,907	56,895	73,812
Impairment of development costs	-	-	-	-
(Gain) loss on foreign exchange	(7,304)	(5,458)	(7,236)	(4,199)
	632,759	456,289	1,200,075	962,576
Loss before the following	(199,248)	(26,165)	(476,495)	(242,423)
Interest expense	517	2,346	1,234	3,951
Interest income	(1,232)	(1,155)	(3,010)	(1,768)
Loss and comprehensive loss for the period	(198,533)	(27,356)	(474,719)	(244,606)
Deficit, beginning of period	(8,073,710)	(7,773,196)	(7,797,524)	(7,555,946)
Deficit, end of period	(8,272,243)	(7,800,552)	(8,272,243)	(7,800,552)
Basic and diluted loss and comprehensive loss per common share (note 6)	(0.01)	(0.00)	(0.01)	(0.01)
Weighted average number of common shares outstanding (note 6)	39,220,475	34,936,725	39,220,475	34,936,725

The accompanying notes are an integral part of these interim consolidated financial statements

# THERALASE® TECHNOLOGIES INC.

Consolidated Statements of Cash Flows

For the six and three-month period ended June 30

Stated in Canadian Dollars

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	2010	2009
<b>Cash flows from operating activities</b>				
Net loss for the period	\$ (198,533)	\$ (27,356)	\$ (474,719)	\$ (244,606)
Items not involving cash				
Amortization of property and equipment	8,309	8,400	16,388	16,871
Amortization of intangibles	28,551	36,907	56,895	73,812
Stock-based compensation expense	55,726	29,334	136,192	60,596
(Gain) loss on foreign exchange	(7,304)	(5,458)	(7,236)	(4,199)
Lease inducements	(3,246)	8,073	(5,795)	5,496
Impairment of development costs	-	-	-	-
	(116,497)	49,900	(278,275)	(92,030)
Change in operating assets and liabilities other than cash				
Accounts receivable	(196,144)	(143,479)	62,489	(23,359)
Inventory	20,751	64,552	17,476	70,665
Prepaid expenses and other assets	(12,902)	12,235	801	18,839
Accounts payable and accrued liabilities	30,944	8,094	(121,430)	(98,357)
Deferred Revenue	(21,235)	3,738	(24,363)	13,862
	(295,083)	(4,960)	(343,303)	(110,380)
<b>Cash flows from investing activities</b>				
Purchase of property and equipment	(9,086)	408	(20,702)	(3,899)
Investment in development costs	-	-	-	-
Investment in patents and trademarks	(19,508)	(410)	(26,521)	(1,333)
	(28,594)	(2)	(47,223)	(5,232)
<b>Cash flows from financing activities</b>				
(Repayment) of bank loan	-	30,000	-	115,000
(Repayment) of capital lease obligation	(140)	(2,252)	(1,810)	(3,548)
Proceeds from the exercising of share warrants	18,750	-	18,750	-
Proceeds from private placement unit issuance	-	-	-	-
	18,610	27,748	16,940	111,452
(Decrease) increase in cash and cash equivalents during the period	\$ (305,067)	\$ 22,786	\$ (373,586)	\$ (4,160)
Cash and cash equivalents, beginning of period	\$ 1,118,585	\$ 22,188	\$ 1,187,104	\$ 49,134
Cash and cash equivalents, end of period	\$ 813,518	\$ 44,974	\$ 813,518	\$ 44,974
<b>Cash and cash equivalents</b>				
Cash	\$ 813,518	\$ 44,974	\$ 813,518	\$ 44,974
Cash equivalents	\$ -	\$ -	\$ -	\$ -
	\$ 813,518	\$ 44,974	\$ 813,518	\$ 44,974

# THERALASE® TECHNOLOGIES INC.

Statement of Shareholders' Equity

As at June 30, 2010 and December 31, 2009

Stated in Canadian Dollars

	Number of Shares	Share Capital	Contributed Surplus	Common Share Purchase Warrants	Deficit	Total Shareholders' Equity
	#	\$	\$	\$	\$	\$
<b>Balance, December 31, 2007</b>	34,936,725	7,089,139	2,623,792	103,495	(6,444,271)	3,372,155
Stock-based compensation expense	-	-	126,272	-	-	126,272
Issued pursuant to private placement	-	-	103,495	(103,495)	-	-
Loss for the year	-	-	-	-	(1,111,675)	(1,111,675)
<b>Balance, December 31, 2008</b>	34,936,725	7,089,139	2,853,559	-	(7,555,946)	2,386,752
Stock-based compensation expense	-	-	95,838	-	-	95,838
Expired share purchase warrants	-	-	-	-	-	-
Issued pursuant to private placement	4,235,833	891,020	-	354,909	-	1,245,929
Loss for the period	-	-	-	-	(241,578)	(241,578)
<b>Balance, December 31, 2009</b>	39,172,558	7,980,159	2,949,397	354,909	(7,797,524)	3,486,941
Stock-based compensation expense	-	-	136,192	-	-	136,192
Expired share purchase warrants	-	-	-	-	-	-
Exercising of common share warrants	47,917	29,593	-	(8,030)	-	21,563
Loss for the period	-	-	-	-	(474,719)	(474,719)
<b>Balance, June 30, 2010</b>	39,220,475	8,009,752	3,085,589	346,879	(8,272,243)	3,169,977

# ThERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

For the six-months ended June 30, 2010

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### 1. Nature of operations

Theralase Technologies Inc. (the company or Theralase) designs, develops and manufactures patented, super-pulsed laser technology used in bio-stimulative and bio-destructive clinical applications. The Theralase technology platform targets several health-care sectors: first, for non-invasive pain management and clinical therapy, used in neural muscular skeletal conditions including arthritis and osteoarthritis; second, wound care and healing (including non-healing fractures and bone fracture regeneration); and third, research and development into combining patented photodynamic compounds with patented, super-pulsed, biofeedback laser technology to attack specifically targeted cancers, bacteria and viruses.

The company develops products both internally and using the assistance of specialist external resources. Successful financing enables the commercialization of the company's current and future product offerings, which is further supported through the company's established network of direct, distribution and strategic alliance sales.

The company's common shares trade on the Toronto Stock Exchange Venture Exchange under the symbol TLT.

### 2. Summary of significant accounting policies

These unaudited interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements ("Canadian GAAP") and are prepared following accounting policies consistent with the Company's annual financial statements and related notes thereto for the three-month period ended June 30, 2010

#### Adoption of New Accounting Standards

Effective January 1, 2009, the company adopted The Canadian Institute of Chartered Accountants (CICA) Handbook Section 3064, Goodwill and Intangible Assets. Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. These standards are effective for the company for its consolidated financial statements for fiscal years beginning on or after October 1, 2008. The adoption of this standard did not have a material impact on the company's consolidated financial statements.

On January 20, 2009, the Emerging Issues Committee (EIC) of the Canadian Accounting Standards Board (AcSB) issued EIC Abstract 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities (EIC-173), which establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC-173 is applied retrospectively, without restatement of prior years, to all financial assets and financial liabilities measured at fair value in the interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of EIC-173 did not have an impact on the consolidated financial statements of the company.

In June 2009, the AcSB issued amendments to CICA Handbook Section 3862, Financial Instruments - Disclosures, in order to align with International Financial Reporting Standard (IFRS) 7, Financial Instruments: Disclosures. This standard has been amended to include additional disclosure requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure. The amendments establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: level 1, defined as observable inputs such as quoted prices in active markets; level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and level 3, defined as unobservable inputs in which little or no market data exists and, therefore, requiring an entity to develop its own assumptions. The amendments apply to financial statements relating to fiscal years ending on or after September 30, 2009 and are applicable to

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

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the company as at December 31, 2009. The amended standard relates to disclosure only and did not impact the financial results of the company.

### Future accounting pronouncements

The company reviews all changes to the CICA Handbook when issued. The following became effective January 1, 2010:

- i The CICA issued three new accounting standards in January 2009: Section 1582, Business Combinations; Section 1601, Consolidated Financial Statements; and Section 1602, Non-controlling Interests. The company is in the process of evaluating the requirements of the new standards. Section 1582 establishes standards for the accounting for a business combination. It provides the Canadian equivalent to IFRS 3, Business Combinations. The standards apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 and early adoption is permitted. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements. It is equivalent to the corresponding provisions of International Accounting Standard 27, Consolidated and Separate Financial Statements, and Sections 1601 and 1602, and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.
- ii In February 2008, the AcSB confirmed that Canadian GAAP, as used by publicly accountable enterprises, would be fully converged into IFRS, as issued by the International Accounting Standards Board. The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. As a result, the company will be required to report under IFRS for its 2011 interim and annual consolidated financial statements. The company will convert to these new standards according to the timetable set within these new standards. The company will determine at a future date the impact of adopting these standards on its consolidated financial statements.
- iii In December 2009, the CICA issued EIC Abstract 175, Multiple Deliverable Revenue Arrangements (EIC-175), which replaces EIC-142, Revenue Arrangements with Multiple Deliverables. This abstract was amended to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated. The abstract requires, in situations where a vendor does not have vendor specific objective evidence or third party evidence of selling prices, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method; and requires expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes summarized in EIC-175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. The company is currently assessing the impact of this abstract.

### 3. Bank loan

The bank loan is a revolving line of credit, repayable on demand and bears interest at the bank's prime rate plus 2%. The balance of the bank loan for the three month period ended June 30, 2010 is \$nil (2009- \$115,000). It is secured by a general security agreement registered against the Company and its Canadian subsidiary.

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

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### 4. Private Placement

On November 26, 2009, the company completed a financing by way of a non-brokered private placement, where 4,235,833 units were issued at a price of \$0.30 per unit for gross proceeds of \$1,270,750. Each unit consists of 1 common share and one half of a non-transferable common share purchase warrant with a four-month holding period. Each whole warrant entitled the holder thereof to acquire 1 common share at a price of \$0.45, expiring on November 26, 2011.

The company received net proceeds of \$1,245,929 (gross proceeds of \$1,270,750, less expenses of \$24,821). The purchase price of \$0.30 per unit was allocated between the common shares (\$0.215 per share) and common share purchase warrants (\$0.085 per warrant), based on their relative fair values. Management determined that the allocation of the proceeds was \$891,020 for the common shares issued and \$354,909 for the common share purchase warrants issued.

The fair value of each common share purchase warrant granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.1%
Expected volatility	179%
Expected life	2 years
Expected dividends	\$nil

During 2Q10 a total of 47,917 common share purchase warrants associated with the November 26, 2009 private placement were exercised for proceeds of \$21,563 in which \$2,813 was received in 3Q10. The exercising of these common share purchase warrants reduced the outstanding common share purchase warrants to 2,070,000 with a relative fair value of \$346,879. Common share equity increased by \$29,592 as a result of this transaction.

### 5. Incentive stock options

The company has a rolling stock option plan reserving for issue under this plan 10% (3,922,048 common shares) of the outstanding common shares. Under the company's stock option plan, the board of directors may grant, at its discretion, stock options to purchase common shares to certain employees, officers, directors and consultants of the company. Terms and conditions of the stock option and vesting provisions are at the discretion of the board of directors.

A summary of stock options issued under the stock option plan for the six-months ended June 30 is provided below.

	2010		2009	
	Number of Options	Weighted Exercise Price	Number of Options	Weighted Exercise Price
Outstanding beginning of year	3,050,000	\$ 0.54	2,550,000	\$ 0.58
Granted during the year <sup>(1)</sup>	100,000	0.45	100,000	0.15
Granted during the year <sup>(2)</sup>	-	-	300,000	0.35
Granted during the year <sup>(3)</sup>	-	-	100,000	0.45
<b>Options outstanding at end of year</b>	<b>3,150,000</b>	<b>\$ 0.54</b>	<b>3,050,000</b>	<b>\$ 0.54</b>

1) On January 14, 2009, the company granted a total of 100,000 stock options to a director of the company. On January 1, 2010, the company granted a total of 100,000 stock options to certain business development consultants.

2) On August 18, 2009, the company granted a total of 300,000 stock options to certain marketing and media relations consultants.

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

3) On November 24, 2009 the company granted a total of 100,000 stock options to certain media relations consultants.

The following table summarizes information on the stock options outstanding as at June 30, 2010:

Stock Options Outstanding					Stock Options Exercisable		
Stock Options Outstanding	Exercise Price	Weighted Average Remaining Life (years)	Weighted Average Exercise Price \$		Stock Options Exercisable	Weighted Average Exercise Price \$	
350,000	\$ 0.60	0.8	\$ 0.60		350,000	\$ 0.60	
2,000,000	\$ 0.60	1.0	\$ 0.60		2,000,000	\$ 0.60	
100,000	\$ 0.60	2.3	\$ 0.60		66,666	\$ 0.60	
100,000	\$ 0.10	3.4	\$ 0.10		33,333	\$ 0.10	
100,000	\$ 0.15	3.5	\$ 0.15		33,333	\$ 0.15	
300,000	\$ 0.35	4.1	\$ 0.35		-	\$ -	
100,000	\$ 0.45	4.4	\$ 0.45		-	\$ -	
100,000	\$ 0.45	4.5	\$ 0.45		-	\$ -	
<b>3,150,000</b>			<b>\$ 0.54</b>		<b>2,483,332</b>	<b>\$ 0.59</b>	

Under the stock option plan, the stock options vest in equal instalments over a period of three years, commencing one year after the grant. As at June 30, 2010, 2,483,332 of the stock options were vested. All outstanding stock options as at June 30, 2010 will be fully vested by January 1, 2015.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2010	2009
Risk-free interest rate	2.179%	2.700%
Expected volatility	167%	158%
Expected life	5 years	5 years
Expected dividends	nil	nil
Weighted average grant date fair value	\$0.537	\$0.386

For the six months ended June 30, 2010, the company recognized stock-based compensation expense of \$136,192 (2009 - \$60,596) for stock options issued to directors, employees, medical scientific and advisory board, marketing and media relation consultants, and business development consultants.

## 6. Loss and comprehensive loss per common share

Basic loss and comprehensive loss per common share has been calculated based on the weighted average number of common shares outstanding during each of the years presented in the consolidated financial statements.

Basic and diluted loss and comprehensive loss per common share for the six months ended June 30 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	2010	2009
Loss for the year	\$ (198,533)	\$ (27,356)	\$ (474,719)	\$ (244,606)
Weighted average number of common shares	39,220,475	39,172,558	34,936,725	34,936,725
<b>share</b>	<b>\$ (0.01)</b>	<b>\$ (0.00)</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>

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## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

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Stock options to purchase 3,150,000 common shares and common share purchase warrants totaling 2,070,000 were not included in the computation of diluted loss and comprehensive loss per common share for the six months ended June 30, 2010 and 2009 due to their anti-dilutive nature.

### 7. Financial risk management

#### i Credit risk

Credit risk is the risk of financial loss to the company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the company's accounts receivable. The amounts reported in the consolidated balance sheets are net of allowances for bad debts, estimated by the company's management based on prior experience and its assessment of the current economic environment. The company reviews its trade receivable accounts regularly and reduces amounts to their expected realizable values by adjusting the allowance for doubtful accounts when management determines that the account may not be fully collectible. The company has adopted credit policies in an effort to minimize those risks.

Cash equivalents are held in high-grade bankers' acceptances and other low risk investments with no exposure to liquidity or other risk associated with asset-backed securities. These financial instruments are classified as held-for-trading, as they may periodically be traded before their maturity date. However, the majority of these financial instruments are held to maturity and would not result in a significant risk of fair value changes if held to maturity. As at June 30, 2010, no cash equivalents were held (2009 - \$nil).

The following table reflects the balance and age of trade receivables as at June 30:

	2010	2009
Total receivables carrying amount	\$ 501,619	\$ 557,847
Percentage past due	11%	24%
Percentage outstanding more than 120 days	6%	17%

The following table reflects the changes in the allowance for trade receivables during the six-month period ended June 30:

	2010	2009
Allowance for trade receivables - beginning of year	\$ 11,705	\$ 44,003
Allowance recorded against current year's sales	654	-
Adjustment based on collection experience	(530)	-
Amounts written off	(331)	-
Allowance for trade receivables - end of year	<u>\$ 11,497</u>	<u>\$ 44,003</u>

#### ii Liquidity risk

Liquidity risk is the risk that the company will not be able to meet its financial obligations as they come due. The company manages its liquidity risk by continuously monitoring forecasted and actual cash flows, as well as anticipated investing and financing activities. The company does not have long-term financial liabilities.

The table below reflects the contractual obligations of the company's undiscounted cash flows for its financial liabilities:

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## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

Contractual Obligations	Payments Due by Period				
	Total	2010	2011	2012	2013 - 2015
Liabilities	\$ 439,992	\$ 439,992	\$ -	\$ -	\$ -
Capital Lease Obligations	16,300	3,605	7,658	4,096	941
Total Contractual Obligations	\$ 456,292	\$ 443,597	\$ 7,658	\$ 4,096	\$ 941

The company also has significant contractual obligations (note 10) in the form of lease obligations related to the company's premises and research and development commitments.

### iii Interest rate risk

Interest rate risk is the risk that changes in interest rates will affect the company's income or the value of the financial instruments held.

The company is subject to interest rate risk on its cash and cash equivalents; however, it does not expect a movement in interest rates to have a significant impact on the company's financial position.

### iv Foreign currency exchange risk

The company is exposed to foreign currency exchange risk. This risk arises from the company's holdings of US dollar denominated cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. Changes arising from this risk could impact the company's reported foreign currency exchange gains or losses.

Accounts exposed to foreign currency exchange risk as at June 30, 2010 are as follows:

Cash and cash equivalents	\$ 88,913
Accounts receivable	324,579
Accounts payable and accrued liabilities	61,259
<b>Total</b>	<b>\$ 474,750</b>

The above US dollar balances are shown in Canadian dollar equivalents.

### v Foreign currency exchange risk sensitivity analysis

The following table details the company's sensitivity analysis to a 10% strengthening in the US dollar on foreign currency denominated monetary items and adjusts its translation at the consolidated balance sheet dates for a 10% change in foreign currency exchange rates. For a 10% weakening of the US dollar against the Canadian dollar, there would be an equal and opposite impact on loss and comprehensive loss for the year.

The change in foreign currency exchange gain (loss) resulting from a US dollar 10% currency strengthening as at June 30, 2010 is as follows:

Cash and cash equivalents increase	\$ 8,891
Accounts receivable increase	32,458
Accounts payable and accrued liabilities (increase)	(6,126)
<b>Total</b>	<b>\$ 35,223</b>

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## Notes to Consolidated Financial Statements

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### 8. Capital Disclosures

The company's objective is to maintain a sufficient capital base to sustain future research and development initiatives, strategic business initiatives and to maintain investor, creditor and market confidence. The company makes every attempt to manage its liquidity to minimize shareholder dilutions when possible.

For the six-months ended June 30, 2010, the company reported a loss of \$474,719 and an accumulated deficit of \$8,272,243 as at that date. Sales of the TLC-1000, the company's existing product line, have not been sufficient in and of themselves to enable the company to fund all its continuing development and commercialization efforts and, accordingly, management is pursuing alternate financing sources to fund the company's development and commercialization efforts. Similar to the financing secured through the private placement that took place on November 26, 2009, management believes that the company will be able to secure the necessary financing through a combination of the issue of new equity or debt instruments, entering into joint venture arrangements and strategic alliances. Nevertheless, there is no assurance that these initiatives will be successful.

The company's policy is to maintain a minimum level of debt. The company has a line of credit of \$125,000 for its short-term financing needs. As at June 30, 2010, there are no amounts drawn on this line of credit.

As at June 30, 2010, cash on hand amounted to \$813,518 and accounts receivable, net of allowance for doubtful accounts, amounted to \$511,116, for a total of \$1,324,634. The company believes that its cash position will be sufficient to finance its operations and capital needs beyond the next year.

The company is not subject to any externally imposed capital requirements and the company does not use financial ratios to manage capital.

### 9. Segmented information

The company is organized and managed as a single reportable business segment. The company's operations are substantially all related to the research, design, manufacture and sales of therapeutic laser products and services.

The following table displays revenue from product sales by geographic area for the six months ended June:

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	2010	2009
Canada	\$ 261,780	\$ 531,018	\$ 653,423	\$ 934,070
United States	106,973	81,057	127,009	131,833
International	271,517	16,929	321,920	24,479
	<b>\$ 640,270</b>	<b>\$ 629,004</b>	<b>\$ 1,102,351</b>	<b>\$ 1,090,382</b>

As at June 30, 2010 and 2009, the company's long-lived assets used in operations are all located in Canada.

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## Notes to Consolidated Financial Statements

For the six-months ended June 30, 2010

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### 10. Commitments

The company's commitments consist of the following:

	2010	2011	2012	Total
Lease obligations (a)	\$ 26,664	\$ 53,873	\$ 31,426	\$ 111,962
Research commitments (b)	108,824	56,776	-	165,600
<b>Total</b>	<b>\$ 135,488</b>	<b>\$ 110,649</b>	<b>\$ 31,426</b>	<b>\$ 277,562</b>

- a) Lease obligations under a lease agreement related to the company's premises, which commenced on August 1, 2007 and expires on July 31, 2012. Under the terms of this lease, the company is required to pay a proportionate share of operating costs, realty taxes and utilities, in addition to the minimum rental payments. The future minimum lease payments are shown in the table above.
- b) Research commitments under a research collaboration agreement with Virginia Polytechnic Institute and State University for the TLC-3000 cancer therapy project. Under the terms of this agreement, the company is required to pay \$266,597 for the period from September 2009 through May 2011. During 2009 the company incurred billings amounting to \$43,390 relating to this commitment, of which \$43,390 was paid under this agreement. For the six months ended June 30, 2010, the company incurred \$57,607 in expenses related to this commitment, of which \$nil was paid under this agreement.
- c) The company indemnifies its directors and officers against any and all costs, charges and expenses, including settlements of claims in respect of any civil, criminal or administrative action incurred in the performance of their service to the company to the extent permitted by law. The company maintains liability insurance for its officers and directors.

### 11. Comparative figures

Certain comparative figures have been reclassified to conform with the consolidated financial statement presentation adopted in the current quarter.