

Theralase Technologies Inc.

Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

April 28, 2010

Auditors' Report

To the Shareholders of Theralase Technologies Inc.

We have audited the consolidated balance sheets of **Theralase Technologies Inc.** as at December 31, 2009 and 2008 and the consolidated statements of operations, comprehensive loss and deficit, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Accountants, Licensed Public Accountants

Theralase Technologies Inc.

Consolidated Balance Sheets

As at December 31, 2009 and 2008

(expressed in Canadian dollars)

| | 2009 \$ | 2008 \$ |
|---|-------------|-------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 1,187,104 | 49,134 |
| Accounts receivable | 563,556 | 487,064 |
| Inventory (note 5) | 200,413 | 274,835 |
| Prepaid expenses and other assets | 50,831 | 46,989 |
| | <hr/> | <hr/> |
| | 2,001,904 | 858,022 |
| Property and equipment (note 6) | 105,533 | 117,978 |
| Intangible assets (note 7) | 222,326 | 344,460 |
| Goodwill | 1,861,078 | 1,861,078 |
| | <hr/> | <hr/> |
| | 4,190,841 | 3,181,538 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 561,422 | 674,044 |
| Capital lease obligation - current | 6,876 | 2,456 |
| Deferred revenue - current | 28,444 | 23,096 |
| | <hr/> | <hr/> |
| | 596,742 | 699,596 |
| Capital lease obligation | 11,234 | 21,915 |
| Deferred revenue | 59,452 | 36,775 |
| Leasehold inducement | 36,472 | 36,500 |
| | <hr/> | <hr/> |
| | 703,900 | 794,786 |
| Shareholders' Equity | | |
| Share capital (note 12) | 7,980,159 | 7,089,139 |
| Common share purchase warrants (note 10) | 354,909 | - |
| Contributed surplus (note 14) | 2,949,397 | 2,853,559 |
| Deficit | (7,797,524) | (7,555,946) |
| | <hr/> | <hr/> |
| | 3,486,941 | 2,386,752 |
| | <hr/> | <hr/> |
| | 4,190,841 | 3,181,538 |

Commitments (note 20)

Approved by the Board of Directors

(signed) "S. Donald Moore" Director

(signed) "Roger Dumoulin-White" Director

Theralase Technologies Inc.

Consolidated Statements of Operations, Comprehensive Loss and Deficit For the years ended December 31, 2009 and 2008

(expressed in Canadian dollars)

| | 2009 | 2008 |
|---|-------------|-------------|
| | \$ | \$ |
| Sales | 2,359,855 | 2,168,411 |
| Cost of sales | 799,729 | 688,942 |
| Gross margin | 1,560,126 | 1,479,469 |
| Operating expenses | | |
| Selling | 476,416 | 633,028 |
| Administrative | 992,742 | 1,336,675 |
| Research and development | 164,184 | 226,748 |
| Amortization of property and equipment | 33,176 | 31,641 |
| Amortization of intangible assets | 142,399 | 147,622 |
| Impairment of development costs | - | 198,804 |
| (Gain) loss on foreign currency exchange | (6,962) | 16,136 |
| | 1,801,955 | 2,590,654 |
| Loss before the following | (241,829) | (1,111,185) |
| Interest expense | 5,618 | 10,325 |
| Interest income | (5,869) | (9,835) |
| Loss and comprehensive loss for the year | (241,578) | (1,111,675) |
| Deficit - Beginning of year | (7,555,946) | (6,444,271) |
| Deficit - End of year | (7,797,524) | (7,555,946) |
| Basic and diluted loss and comprehensive loss per common share (note 13) | (0.01) | (0.03) |
| Weighted average number of common shares outstanding (note 13) | 35,354,506 | 34,936,725 |

Theralase Technologies Inc.

Consolidated Statements of Shareholders' Equity For the years ended December 31, 2009 and 2008

(expressed in Canadian dollars)

| | Number of shares | Share capital \$ | Contributed surplus \$ | Common share purchase warrants \$ | Deficit \$ | Total shareholders' equity \$ |
|---|---------------------|------------------------|------------------------------|---|---------------|--|
| Balance - December 31, 2007 | 34,936,725 | 7,089,139 | 2,623,792 | 103,495 | (6,444,271) | 3,372,155 |
| Stock-based compensation expense (note 11) | - | - | 126,272 | - | - | 126,272 |
| Expired warrants | - | - | 103,495 | (103,495) | - | - |
| Loss for the year | - | - | - | - | (1,111,675) | (1,111,675) |
| Balance - December 31, 2008 | 34,936,725 | 7,089,139 | 2,853,559 | - | (7,555,946) | 2,386,752 |
| Stock-based compensation expense (note 11) | - | - | 95,838 | - | - | 95,838 |
| Issued pursuant to private placement (note 10) | 4,235,833 | 891,020 | - | 354,909 | - | 1,245,929 |
| Loss for the year | - | - | - | - | (241,578) | (241,578) |
| Balance - December 31, 2009 | 39,172,558 | 7,980,159 | 2,949,397 | 354,909 | (7,797,524) | 3,486,941 |

Theralase Technologies Inc.
Consolidated Statements of Cash Flows
For the years ended December 31, 2009 and 2008

(expressed in Canadian dollars)

| | 2009 \$ | 2008 \$ |
|---|------------|-------------|
| Cash provided by (used in) | | |
| Operating activities | | |
| Loss for the year | (241,578) | (1,111,675) |
| Items not involving cash | | |
| Amortization of property and equipment | 33,176 | 31,641 |
| Amortization of intangible assets | 142,399 | 147,622 |
| Stock-based compensation expense | 95,838 | 126,272 |
| (Gain) loss on foreign currency exchange | (6,962) | 6,668 |
| Leasehold inducement | (28) | 2,694 |
| Impairment of development costs | - | 198,804 |
| | 22,845 | (597,974) |
| Changes in operating assets and liabilities other than cash | | |
| Accounts receivable | (49,780) | (159,213) |
| Inventory | 74,422 | (54,699) |
| Prepaid expenses and other assets | (3,842) | 28,092 |
| Accounts payable and accrued liabilities | (112,622) | 382,728 |
| Deferred revenue | 28,025 | 49,871 |
| | (40,952) | (351,195) |
| Investing activities | | |
| Purchase of property and equipment | (20,731) | (31,020) |
| Investment in development costs | - | (59,459) |
| Investment in patents and trademarks | (20,265) | (13,203) |
| | (40,996) | (103,682) |
| Financing activities | | |
| Repayment of capital lease obligation | (6,261) | (3,958) |
| Proceeds from private placement unit issuance (note 10) | 1,226,179 | - |
| | 1,219,918 | (3,958) |
| Increase (decrease) in cash and cash equivalents during the year | 1,137,970 | (458,835) |
| Cash and cash equivalents - Beginning of year | 49,134 | 507,969 |
| Cash and cash equivalents - End of year | 1,187,104 | 49,134 |
| Cash and cash equivalents consist of: | | |
| Cash | 1,187,104 | 29,151 |
| Cash equivalents | - | 19,983 |
| | 1,187,104 | 49,134 |
| Supplementary information | | |
| Interest paid | 5,618 | 10,325 |
| Interest received | 5,864 | 13,321 |

Theralase Technologies Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(expressed in Canadian dollars)

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, viruses and fat cells.

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

Basis of presentation and principles of consolidation

The consolidated financial statements have been prepared by the company in accordance with Canadian generally accepted accounting principles (GAAP), are stated in Canadian dollars and include the accounts of the company and its 100% interest in Theralase Inc. and Theralase Biotech Inc. All intercompany transactions and balances have been eliminated.

Cash and cash equivalents

Cash includes cash held in a Canadian Schedule I bank. Cash equivalents consist of high-grade investments with maturities averaging three months or less at the date of acquisition.

Financial instruments

The company's financial instruments include cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The financial instruments held by the company are all considered level 1. The company has designated cash and cash equivalents as held-for-trading and measures these instruments at fair value, which approximates cost plus accrued interest. Accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities are classified as other financial liabilities. Accounts receivable and accounts payable and accrued liabilities are carried at cost as, due to the short-term nature of these instruments, cost approximates fair value.

Theralase Technologies Inc.

Notes to Consolidated Financial Statements

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Investment tax credits

The company is entitled to refundable and non-refundable Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible research and development expenditures incurred in each taxation year. Investment tax credits are accounted for as a reduction of the related expenditure for items of a current nature and as a reduction of the related asset's cost for items of a long-term nature, provided that the company has reasonable assurance that investment tax credits will be realized.

Research and development costs

Research costs, net of related investment tax credits, government grants and other amounts recoverable, are expensed in the year in which they are incurred. Development costs are expensed in the year incurred unless such costs meet the criteria under Canadian GAAP for deferral and amortization.

Development costs are capitalized for clearly defined, technically feasible technologies, which management intends on producing and promoting to an identified future market with existing or estimated future resources. The company annually evaluates deferred development costs to consider whether these costs continue to meet the criteria for deferral. Amortization of development costs commences when an asset is substantially completed and becomes available for productive commercial use, and is calculated using the straight-line basis, based on the life of the related product, which is estimated to be ten years.

Revenue recognition

Sales include product sales revenue and clinic services revenue. Product sales revenue is recognized when there is an unconditional sales order, title passes to the customer, the fee is fixed and ultimate collection of the consideration is reasonably assured. Clinic services revenue is recognized when the service is delivered to the patient and collection is reasonably assured.

Deferred revenue consists of unearned revenue from the sale of extended warranty plans and sales with payment terms extending beyond one year.

Stock-based compensation

The company has a stock option plan for directors, consultants, officers and employees, which is described in note 11.

The company uses the fair value based method of accounting for these stock options. Under the fair value based method, compensation costs are measured at fair value at the date of grant and are expensed using the graded vesting method over the stock options' vesting periods.

The fair value of granted stock options is determined using the Black-Scholes valuation model.

Theralase Technologies Inc.

Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

Translation of foreign currencies

Account balances and transactions denominated in foreign currencies are translated into Canadian dollars. Monetary assets and liabilities are converted into Canadian dollars at the exchange rates in effect at the consolidated balance sheet dates and non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are converted at average rates prevailing during the year, except for amortization, which is converted at historical rates. Conversion gains and losses are reflected in net earnings or loss.

Theralase Biotech Inc. is an integrated US foreign subsidiary of the company, whose financial statements are translated into Canadian dollars using the temporal method.

Inventory

Raw materials are valued at the lower of cost and net realizable value. Finished goods are valued at the lower of cost and net realizable value and consist of the following costs: raw materials, subcontracting, direct and indirect labour and the applicable share of manufacturing overhead. Finished goods are determined on a first-in, first-out basis.

Property and equipment

Property and equipment are recorded at cost. Amortization of property and equipment, other than leasehold improvements and rental units, is calculated using the declining balance basis to amortize the cost of the assets over their estimated useful lives using the following annual rates:

| | |
|------------------------|-----|
| Tools and dies | 25% |
| Computer equipment | 30% |
| Furniture and fixtures | 20% |
| Equipment | 25% |

Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the leasehold or the initial lease term.

Rental units are amortized on straight-line basis over five years based on the estimated useful life of the equipment.

Property and equipment are evaluated for impairment whenever events or changes in circumstances indicate their carrying value might not be recoverable. If it is determined that the carrying value of the asset exceeds its fair value, the asset is written down to fair value, with the impairment loss recorded in the consolidated statements of operations, comprehensive loss and deficit.

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Intangible assets

Intangible assets are recorded at cost. Amortization of intangible assets is recorded on a straight-line basis over the estimated useful lives of the related assets as follows:

| | |
|---|----------|
| Patents | 17 years |
| Trademarks | 17 years |
| Development costs | 10 years |
| Food and Drug Administration (FDA) clinical study costs | 5 years |

On an ongoing basis, management reviews the valuation and amortization of intangible assets, taking into consideration any events and circumstances which might have impaired their carrying values. If it is determined that the carrying value exceeds the fair value of the intangible asset, the intangible asset is written down to its fair value, with the impairment loss recorded in the consolidated statements of operations, comprehensive loss and deficit.

Lease inducements

Lease inducements received by the company as free rent periods are deferred and amortized on a straight-line basis over the term of the lease and recorded as a reduction in rental expense.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net identifiable assets and intangible assets acquired in the Theralase Inc. business combination. 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 value may not be recoverable. Impairment of goodwill is tested by comparing the carrying value 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 value 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.

Income taxes

The company uses the asset and liability method to account for income taxes. Future income tax assets and liabilities are determined based on temporary differences between the financial reporting and income tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in operations in the period that includes the date of enactment or substantive enactment. Future income tax assets are reduced by a valuation allowance to the extent that it is more likely than not that the asset will be realized. The company has taken a full valuation allowance on its future income tax assets.

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Use of estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates are required to determine revenue recognition, including consideration of multiple deliverables included in warranty and product sales, the allowance for doubtful accounts, the useful lives and recoverability of long-lived assets, recoverability of goodwill, the valuation allowance on future income tax assets, stock-based compensation expense and the allocation of proceeds from the private placement to warrants and common shares. Actual results could differ from those estimates and the differences could be material to these consolidated financial statements.

Loss and comprehensive loss per common share

Basic loss and comprehensive loss per common share is calculated by dividing the net loss and comprehensive loss by the weighted average number of common shares outstanding during the reporting period. Diluted loss and comprehensive loss per common share is calculated by dividing the net loss and comprehensive loss by the sum of the weighted average number of common shares outstanding and the dilutive common equivalent shares outstanding during the year. When the effect of computing diluted loss and comprehensive loss per common share is anti-dilutive, this information is not presented. Common equivalent shares consist of the shares issuable on exercise of stock options calculated using the treasury stock method.

Non-monetary transactions

In the normal course of business, the company sells patented, super-pulsed laser technology in exchange for goods and services. The related revenues are measured at the more reliable measure of the fair value of the asset given up and the fair value of the service received. For the year ended December 31, 2009, the company recognized revenues of \$3,663 (2008 - \$5,816) and selling expenses of \$2,143 (2008 - \$5,816) related to non-monetary transactions. As at December 31, 2009, prepaid expenses and other assets included \$2,143 (2008 - \$15,036) of non-monetary assets.

3 Changes in accounting policies

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

Theralase Technologies Inc.

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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 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 will become effective after December 31, 2009:

- 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.
- 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.

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- 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.

4 Cash and cash equivalents

The cash and cash equivalents as at December 31, 2009 consist of cash held in the bank. Cash and cash equivalents as at December 31, 2008 consisted of cash held in the bank and high-grade bankers' acceptances.

5 Inventory

| | 2009 \$ | 2008 \$ |
|-----------------|---------------|---------------|
| Raw materials | 107,170 | 131,282 |
| Work-in-process | 5,640 | 6,910 |
| Finished goods | 87,603 | 136,643 |
| | <hr/> 200,413 | <hr/> 274,835 |

Theralase Technologies Inc.

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(expressed in Canadian dollars)

6 Property and equipment

| | 2009 | | | 2008 | | |
|---------------------------|----------------|-----------------------------------|----------------|----------------|-----------------------------------|----------------|
| | Cost \$ | Accumulated amortization \$ | Net \$ | Cost \$ | Accumulated amortization \$ | Net \$ |
| Tools and dies | 39,653 | 38,531 | 1,122 | 39,653 | 38,157 | 1,496 |
| Computer equipment | 84,616 | 61,343 | 23,273 | 81,330 | 52,197 | 29,133 |
| Furniture and fixtures | 82,341 | 53,394 | 28,947 | 77,944 | 46,228 | 31,716 |
| Rental units (1) | 44,392 | 15,700 | 28,692 | 31,643 | 8,080 | 23,563 |
| Equipment | 48,442 | 39,943 | 8,499 | 48,441 | 37,110 | 11,331 |
| Leasehold improvements | 29,286 | 14,286 | 15,000 | 28,988 | 8,249 | 20,739 |
| | <u>328,730</u> | <u>223,197</u> | <u>105,533</u> | <u>307,999</u> | <u>190,021</u> | <u>117,978</u> |

1) Rental units consist of TLC-1000 systems used in customer rentals, demonstrations and service loaners.

7 Intangible assets

| | 2009 | | | 2008 | | |
|-----------------------------|------------------|-----------------------------------|----------------|------------------|-----------------------------------|----------------|
| | Cost \$ | Accumulated amortization \$ | Net \$ | Cost \$ | Accumulated amortization \$ | Net \$ |
| Patents | 186,687 | 46,699 | 139,988 | 166,422 | 38,685 | 127,737 |
| Trademarks | 58,346 | 27,214 | 31,132 | 58,346 | 23,782 | 34,564 |
| Development costs | 344,093 | 344,093 | - | 344,093 | 315,069 | 29,024 |
| FDA clinical study costs | 509,649 | 458,443 | 51,206 | 509,649 | 356,514 | 153,135 |
| | <u>1,098,775</u> | <u>876,449</u> | <u>222,326</u> | <u>1,078,510</u> | <u>734,050</u> | <u>344,460</u> |

FDA clinical study costs consist of expenses incurred in conducting the clinical trial Laser Therapy Applications for Chronic Joint Pain used to obtain the FDA clearance in July 2005, which allows for the marketing and sale of the TLC-1000 product line into the US market.

8 Credit facility

The company has a revolving line of credit of \$125,000, 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 December 31, 2009, there are no amounts drawn on this line of credit.

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(expressed in Canadian dollars)

9 Income taxes

Provision for income taxes

| | 2009 | 2008 |
|--|-------------|-------------|
| | \$ | \$ |
| Current income taxes | | |
| Loss and comprehensive loss for the year | (241,578) | (1,111,675) |
| | <hr/> | <hr/> |
| Provision for income taxes at Canadian federal and provincial statutory income tax rate | (79,721) | (372,411) |
| Permanent differences | 35,212 | 45,913 |
| Change in income tax rates | 48,066 | - |
| Other | 30,521 | 24,271 |
| Change in valuation allowance | (34,078) | 302,227 |
| | <hr/> | <hr/> |
| | - | - |

Future income taxes

| | 2009 | 2008 |
|-------------------------------|-------------|-------------|
| | \$ | \$ |
| Future income taxes assets | | |
| Non-capital losses | 266,260 | 425,988 |
| Property and equipment | 117,855 | 58,803 |
| Share issuance costs | 11,490 | 9,738 |
| Patents and trademarks | (39,775) | 8,533 |
| Development costs | 152,056 | 82,247 |
| Reserves | 30,888 | 23,100 |
| Cumulative eligible capital | 5,076 | - |
| | <hr/> | <hr/> |
| | 543,850 | 608,409 |
| Future income tax liabilities | | |
| FDA clinical study costs | 13,928 | 44,409 |
| | <hr/> | <hr/> |
| Net future income tax asset | 529,922 | 564,000 |
| Less: Valuation allowance | 529,922 | 564,000 |
| | <hr/> | <hr/> |
| | - | - |

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Non-capital loss carry-forwards

The company has non-capital losses of approximately \$1,055,206 (2008 - \$1,468,923). The income tax benefit of this income tax recovery has not been recorded. These non-capital losses will expire as follows:

| | \$ |
|------|------------------|
| 2010 | 43,671 |
| 2014 | 178,199 |
| 2015 | 61,465 |
| 2026 | 93,534 |
| 2027 | 327,324 |
| 2028 | 351,013 |
| | <u>1,055,206</u> |

10 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, of which \$19,750 is included in accounts receivable as at December 31, 2009. 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. All common shares sold under this private placement, including common shares issuable on the exercise of the warrants, are restricted from trading until March 27, 2010.

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 |

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11 Incentive stock options

The company has a rolling stock option plan reserving for issue under this plan 10% (3,917,558 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 years ended December 31 is provided below.

| | 2009 | | 2008 | |
|---|--|---|--|---|
| | Number of stock options | Weighted exercise price \$ | Number of stock options | Weighted exercise price \$ |
| Stock options outstanding - Beginning of year | 2,550,000 | 0.58 | 2,750,000 | 0.60 |
| Granted during the year (1) | 100,000 | 0.15 | 100,000 | 0.21 |
| Granted during the year (2) | 300,000 | 0.35 | 100,000 | 0.10 |
| Expired or cancelled during the year (3) | - | - | (300,000) | 0.60 |
| Expired or cancelled during the year (3) | - | - | (100,000) | 0.21 |
| | <u>2,950,000</u> | <u>0.54</u> | <u>2,550,000</u> | <u>0.58</u> |

- 1) On January 14, 2009, the company granted a total of 100,000 stock options to a director of the company. On June 26, 2008, the company granted a total of 100,000 stock options to a director of the company.
- 2) On November 18, 2008, the company granted a total of 100,000 stock options to a director of the company. On November 16, 2009, the company granted a total of 300,000 stock options to certain marketing and media relations consultants.
- 3) On June 26, 2008 and July 26, 2008, certain board members resigned from the board of directors or did not stand for re-election and forfeited all non-vested stock options, totalling 300,000, in which \$69,135 of stock-based compensation recognized in prior years was reversed on expiry. On November 18, 2008, certain board members resigned from the board of directors and forfeited all non-vested stock options, totalling 100,000. The forfeiting of these non-vested stock options resulted in a net financial impact of \$nil.

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The following table summarizes information on the stock options outstanding as at December 31, 2009:

| 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 | 1.3 | 0.60 | 350,000 | 0.60 |
| 2,000,000 | 0.60 | 1.5 | 0.60 | 2,000,000 | 0.60 |
| 100,000 | 0.60 | 2.8 | 0.60 | 66,666 | 0.60 |
| 100,000 | 0.10 | 3.9 | 0.10 | 33,333 | 0.10 |
| 100,000 | 0.15 | 4.0 | 0.15 | - | - |
| 300,000 | 0.35 | 4.8 | 0.35 | - | - |
| 2,950,000 | | | | 2,449,999 | |

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 December 31, 2009, 2,449,999 of the stock options were vested. All outstanding stock options as at December 31, 2009 will be fully vested by November 16, 2014.

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:

| | 2009 | 2008 |
|--|-------------------|-------------------|
| Risk-free interest rate | 1.495% - 2.700% | 2.240% - 2.990% |
| Expected volatility | 140% - 158% | 93% - 113.9% |
| Expected life | 5 years | 5 years |
| Expected dividends | nil | nil |
| Weighted average grant date fair value | \$0.133 - \$0.386 | \$0.081 - \$0.152 |

For the year ended December 31, 2009, the company recognized stock-based compensation expense of \$95,838 (2008 - \$126,272) for stock options issued to directors, employees, medical scientific and advisory board and marketing and media relation consultants.

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12 Share capital

Authorized
Unlimited number of common shares

Issued

| | 2009 | | 2008 | |
|-----------------------------|-------------------|----------------------|-------------------|----------------------|
| | Number | Amount \$ | Number | Amount \$ |
| Balance - Beginning of year | 34,936,725 | 7,089,139 | 34,936,725 | 7,089,139 |
| Issued during the year | 4,235,833 | 891,020 | - | - |
| Balance - End of year | <u>39,172,558</u> | <u>7,980,159</u> | <u>34,936,725</u> | <u>7,089,139</u> |

The common shares issued during 2009 were issued for gross proceeds of \$0.30 per unit for cash. Each unit consisted of 1 common share and one half of a non-transferable common share purchase warrant, for which net proceeds of \$0.21 per common share were allocated (note 10).

13 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 years ended December 31 are as follows:

| | 2009 | 2008 |
|--|-------------------|-------------------|
| | \$ | \$ |
| Loss for the year | (241,578) | (1,111,675) |
| Weighted average number of common shares | <u>35,354,506</u> | <u>34,936,725</u> |
| | <u>(0.01)</u> | <u>(0.03)</u> |

Stock options to purchase 2,950,000 common shares and common share purchase warrants totalling 2,117,917 were not included in the computation of diluted loss and comprehensive loss per common share for the years ended December 31, 2009 and 2008 due to their anti-dilutive nature.

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14 Contributed surplus

As at December 31, contributed surplus consisted of the following:

| | 2009 | 2008 |
|--|-----------|-----------|
| | \$ | \$ |
| Balance - Beginning of year | 2,853,559 | 2,623,792 |
| Stock-based compensation expense | 95,838 | 126,272 |
| Expired common share purchase warrants | - | 103,495 |
| | <hr/> | <hr/> |
| Balance - End of year | 2,949,397 | 2,853,559 |

15 Government assistance

The company is eligible to receive grants and investment tax credits from the federal government related to research and development activities. All such amounts are applied against related research and development expenses when collection is reasonably assured. In 2009, an amount of \$85,614 (2008 - \$nil) of investment tax credits has been recorded in accounts receivable and applied against research and development expense, of which \$nil (2008 - \$nil) was received. Of this amount, \$28,205 relates to 2009 expenditures (2008 - \$28,489).

16 Financial risk management

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 December 31, 2009, no cash equivalents were held (2008 - \$19,983).

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The following table reflects the balance and age of trade receivables as at December 31:

| | 2009 | 2008 |
|---|-------------|-------------|
| | \$ | \$ |
| Total trade receivables carrying value | 468,573 | 515,703 |
| Percentage past due | 18% | 54% |
| Percentage outstanding more than 120 days | 14% | 9% |

The following table reflects the changes in the allowance for trade receivables during the years ended December 31:

| | 2009 | 2008 |
|---|---------------|---------------|
| | \$ | \$ |
| Allowance for trade receivables - Beginning of year | 44,003 | 16,300 |
| Allowance recorded against current year's sales | 7,028 | 35,255 |
| Adjustment based on collection experience | (35,892) | (5,093) |
| Amounts written off | (3,434) | (2,459) |
| | <hr/> | <hr/> |
| Allowance for trade receivables - End of year | <u>11,705</u> | <u>44,003</u> |

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:

| Contractual obligations | Payments due by year | | | |
|--|-----------------------------|----------------|--------------|--------------|
| | Total | 2010 | 2011 | 2012 |
| | \$ | \$ | \$ | \$ |
| Accounts payable and accrued liabilities | 561,422 | 561,422 | - | - |
| Capital lease obligations | 20,075 | 8,030 | 8,030 | 4,015 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| | <u>581,497</u> | <u>569,452</u> | <u>8,030</u> | <u>4,015</u> |

The company also has significant contractual obligations (note 20) in the form of lease obligations related to the company's premises and research and development commitments.

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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.

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 December 31, 2009 are as follows:

| | \$ |
|--|-----------------|
| Cash and cash equivalents | (3,905) |
| Accounts receivable | 16,607 |
| Accounts payable and accrued liabilities | <u>(98,723)</u> |
| | <u>(86,021)</u> |

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

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 December 31, 2009 is as follows:

| | \$ |
|--|----------------|
| Cash and cash equivalents | (391) |
| Increase in accounts receivable | 1,661 |
| Increase in accounts payable and accrued liabilities | <u>(9,872)</u> |
| | <u>(8,602)</u> |

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17 Related party transactions

As at December 31, 2009, directors' fees amounting to \$15,625 (2008 - \$1,625) are included in accounts payable and accrued liabilities.

18 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 year ended December 31, 2009, the company reported a loss of \$241,578 and an accumulated deficit of \$7,797,524 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 December 31, 2009, there are no amounts drawn on this line of credit.

As at December 31, 2009, cash on hand amounted to \$1,187,104 and accounts receivable, net of allowance for doubtful accounts, amounted to \$563,556, for a total of \$1,750,660. 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.

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19 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 years ended December 31:

| | 2009 | 2008 |
|---------------|------------------|------------------|
| | \$ | \$ |
| Canada | 1,952,406 | 1,452,750 |
| United States | 188,075 | 469,099 |
| International | 219,374 | 246,562 |
| | <u>2,359,855</u> | <u>2,168,411</u> |

As at December 31, 2009 and 2008, the company's long-lived assets used in operations are all located in Canada.

20 Commitments

The company's commitments consist of the following:

| | 2010 | 2011 | 2012 | 2013 | Total |
|----------------------|---------------|---------------|---------------|-------------|----------------|
| | \$ | \$ | \$ | \$ | \$ |
| Lease obligations | 51,968 | 53,873 | 31,426 | - | 137,267 |
| Research commitments | 43,390 | - | - | - | 43,390 |
| | <u>95,358</u> | <u>53,873</u> | <u>31,426</u> | <u>-</u> | <u>180,657</u> |

- 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 \$86,780 for the period from September 2009 to August 2010. For the year ended December 31, 2009, the company incurred \$43,390 in billings related to this commitment, of which \$nil was paid under this agreement.

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- 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.

21 Comparative figures

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