

Diagno Cure



## Empowering Oncology Decisions

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2009 Annual Report

## **Our Commitment to Patients**

DiagnoCure helps patients and their physicians with the difficult decisions about their cancer treatments. The Company's molecular diagnostic tests look for specific biomarkers that provide a tailored assessment of the stage or prognosis of a person's cancer, and help identify who is more likely to benefit from a cancer treatment. With these results, individuals can choose to undergo treatment with greater confidence, or be spared from the side effects of treatment that may be less beneficial to them. DiagnoCure takes this role very seriously. After all, lives depend on it.

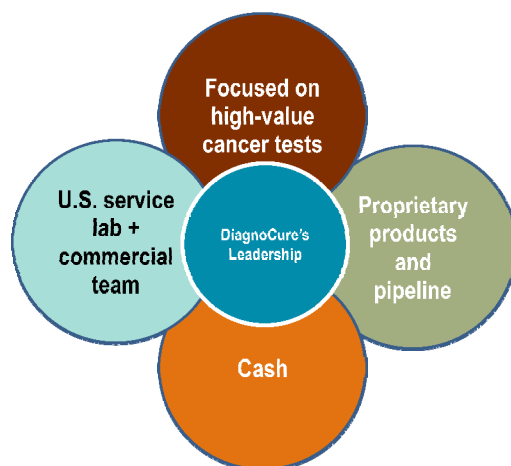
## Message to Shareholders

Dear Shareholders:

After two years of implementing our new business model, DiagnoCure is in a position for success in the high growth personalized diagnostic market. Over the past year, many small to mid-sized companies have announced the discovery of new biomarkers to test various aspects of cancer. Where most of them are not ready for commercialization, DiagnoCure is already in the marketplace with two cancer tests, one for colorectal cancer and one for prostate cancer. These tests provide more accurate information to physicians and patients and are changing treatment decisions based on the new insights they provide.

### A Powerful Business Model

To become the leading developer and provider of high-value diagnostics for the detection and management of cancer, our idea is simple: track the new molecular diagnostic discoveries for cancer, acquire patient-validated biomarkers to build a critical mass of proprietary products, develop tests in a relatively short period of time, and sell them through partners or directly to treating physicians by exploiting a service laboratory in the U.S. certified under the CLIA regulation (Clinical Laboratory Improvement Act). For our shareholders, this means investing in high value proprietary products, with high margins similar to the pharmaceutical industry model, in a high growth market, using the most efficient route to commercialization.



DiagnoCure's business model resulted in many milestones since 2007:

- ▶ Acquisition of novel validated biomarkers for five forms of cancer
- ▶ Establishment of our CLIA-certified service laboratory in the U.S. (DiagnoCure Oncology Laboratories) to offer high-value cancer testing services
- ▶ Development and launch of the Previstage™ GCC Colorectal Cancer Staging Test in the U.S.
- ▶ Implementation of a marketing and commercialization program aimed at reaching physicians, patients and payers
- ▶ Establishment of a partnership with Lab21 for the distribution of the Previstage™ GCC test in the UK and Ireland
- ▶ Amendment of the Company's contract with Gen-Probe with regard to the PCA3 marker for prostate cancer
- ▶ Increasing royalty payments on the PCA3 marker, with the prostate cancer test now being commercialized by Gen-Probe in Europe (over 30 sites) and in the U.S. (in ASR format)
- ▶ Start of a U.S. clinical trial aimed at securing Food and Drug Administration (FDA) approval to commercialize Gen-Probe's PROGENSA® PCA3 prostate cancer test in the U.S.

## **Personalized Diagnostic Tests – Spending the Money Where it Makes Sense**

DiagnoCure focuses on personalized diagnostic tests for cancer as its core business. Cancer, because we believe it is a molecular problem, which should be addressed with molecular solutions. Indeed, the worldwide molecular diagnostics market for cancer is expected to grow at 34% over the coming years.

Cancer is the second leading cause of mortality after heart disease in North America, accounting for one out of every four deaths. One out of two men and one out of three women will develop cancer in their lifetime.

In addition to the personal impact on the lives of many people, cancer inflicts a heavy financial burden on society. According to the U.S. National Institute of Health (NIH), the costs related to cancer in the United States in 2008 totalled US\$228.1 billion, the highest of any disease. There is a growing focus on personalized cancer diagnosis by healthcare providers and payers, because accurate detection, staging, treatment decisions, and monitoring of the disease mean a better chance for patient survival and lower health costs.

### **Three Customers for Personalized Diagnostics Success**

#### ***Involving physicians***

When physicians treat their patients, they want to rely on the best practices and most advanced knowledge that they can trust. DiagnoCure has recognized this challenge from the beginning and started to educate the medical community about its new colorectal cancer staging test almost one year before it was actually launched. The sales and marketing program has built momentum over time with many seminars and advisory meetings held with oncologists, surgeons and pathologists treating colorectal cancer patients. In addition, the Company is pursuing clinical studies to further demonstrate the clinical utility of the Previstage™ GCC Colorectal Cancer Staging Test.

Let's take our Previstage™ GCC test as an example. Up to 30% of stage II colorectal cancer patients may experience a recurrence of their cancer despite receiving an initially positive prognosis based on traditional diagnostic methodologies. In response, 25-30% of stage II colorectal cancer patients are being treated after their surgeries in the U.S., yet the few studies performed to date with the patients have suggested that only 2-4% of benefit from such treatment. This translates into needing to treat 28 stage II patients to benefit only one. This situation calls for more accurate tools to predict the risk of recurrence that will help physicians identify patients that are more likely to benefit from adjuvant therapy.

In a five-year prospective study published in February 2009 (JAMA, Feb 18, 2009, Vol. 301, No. 7), DiagnoCure's GCC biomarker was shown to be the strongest independent predictor of the risk of recurrence in stage I and II patients when compared to the traditional risk factors used today by physicians. We believe that the Previstage™ GCC Colorectal Cancer Staging Test has the potential to change the standards of care for those who are truly at higher risk of recurrence and could, therefore, benefit from adjuvant chemotherapy.

#### ***Involving payers***

DiagnoCure has pursued a value pricing strategy for reimbursement of the Previstage™ GCC test by payers. DiagnoCure still has to obtain Medicare coverage for the test, and establish private payer contracts. Already, the Company has initiated a program to educate the payers about Previstage™ GCC, and its economic value.

### ***Involving patients***

Patients are influencing dynamic changes in medical practices. Because people are more informed and actively participate in their treatment decisions, they must be convinced of the benefits for themselves. They are the ones who have the most to gain or to lose by accepting new testing and new treatments.

In 2009, DiagnoCure launched a new web site dedicated to patients.

[www.mypersonalcancerdiagnosis.com](http://www.mypersonalcancerdiagnosis.com) was developed with the patient in mind, with the help of doctors, patients, patient advocacy groups, and caregivers. The result is an informative website with a personal touch, where patients can get accurate information about colorectal cancer, the challenge of making treatment decisions, and DiagnoCure's Previstage™ GCC Colorectal Cancer Staging Test. The website won three awards this year recognizing communication excellence, notably a Gold e-Healthcare Leadership Award.

### **The Next Phase to Profitability**

Having two tests on the market, Previstage™ GCC and PCA3 (by Gen-Probe), is a great accomplishment. But the real success will come when DiagnoCure reaches profitability. Working towards that goal, DiagnoCure intends to expand its commercialization efforts in support of the Previstage™ GCC Colorectal Cancer Staging Test. In particular, in 2010, the Company will seek potential partners, alliances and distributorships to further leverage its commercial strength, expand the reimbursement coverage by third-party payers, and advance additional clinical studies to further demonstrate the clinical utility of the test.

DiagnoCure will also pursue the development of its proprietary pipeline, notably by internal research and by engaging with potential partners that have the appropriate resources and market reach.

With regard to the PROGENSA® PCA3 test, it is expected that in 2010 Gen-Probe will complete its one-year clinical study aimed at securing FDA approval and continue to expand its market penetration outside of the U.S., and report on additional studies.

In conclusion, 2009 was a year for positioning DiagnoCure squarely in the high growth molecular diagnostic market for cancer and for positioning Previstage™ GCC and PCA3 as helping patients, physicians and payers make critical, cost-effective decisions about the treatment and management of cancer. In that respect, we need to express special thanks to our dedicated team who worked diligently to deliver our 2009 objectives.

In these uncertain financial conditions, we pledge to be prudent managers of our resources. Our goal is to continue to advance the delivery of our business model through the successful commercialization of our products while maintaining an adequate cash position. We are driven to remain true to our mission *to be the leading developer and provider of high-value diagnostic tests for cancer.*

(signed)

**John C. Schafer**  
President and Chief Executive Officer

(signed)

**Yves Fradet**  
Chairman of the Board,  
Chief Medical Officer

# Management's Discussions and Analysis of Financial Condition and Results of Operations

*The following information deals with the Company's operating results and financial position as at October 31, 2009, and therefore should be read in conjunction with the consolidated financial statements and accompanying notes at that same date and included in this annual report. These management comments were prepared to explain the Company's operations, performance and financial position as at October 31, 2009. They compare this fiscal year's operating results and cash position with those of the fiscal year ended October 31, 2008. The information contained herein is up to date as of January 14, 2010.*

## Overview

DiagnoCure, Inc. (hereafter called the "Company" or "DiagnoCure") is a life sciences company commercializing high-value cancer diagnostic tests and laboratory services that increase clinician and patient confidence in making critical treatment decisions.

In 1998, the Company initiated the commercialization of its first diagnostic test, ImmunoCyt™ / uCyt+™ for bladder cancer in Europe and, in 2000, obtained a 510(k) clearance from the Food and Drug Administration (FDA) for the commercialization of the test in the United States. In August 2008, as DiagnoCure looked to maximize the value of its portfolio and focus on high-value molecular diagnostics, the Company entered into a product divestment agreement for ImmunoCyt™ / uCyt+™ with Scimedx Corporation, a U.S.-based company. Terms of the agreement were not disclosed.

In May 2000, DiagnoCure obtained an exclusive worldwide license from the University of Nijmegen, The Netherlands, to commercialize the PCA3 molecular marker in relation with prostate cancer. In 2003, DiagnoCure developed its second diagnostic test, uPM3™, based on measuring the expression of the PCA3 molecular marker. uPM3™ was first sold in 2003 in the United States in an Analyte Specific Reagents (ASR) format. That same year, DiagnoCure granted an exclusive worldwide license to Gen-Probe Incorporated (Gen-Probe) of San Diego, California, for the development and commercialization of diagnostic products using PCA3 in return for US\$9 million to be paid over three years. This revenue has been recognized and amortized over a 42-month period ended in April 2007. The final payment has been received in November 2006. In mid-2006, Gen-Probe made available to targeted reference laboratories in the U.S. market the ASR format of its first generation PCA3 assay on its APTIMA® technology platform. Since then, a number of laboratories in the U.S. have added PCA3 on their product listings, among which are LabCorp and Quest, the two leading U.S. diagnostic testing providers. In November 2006, Gen-Probe received the European CE Mark for its PROGENSA® PCA3 test and subsequently introduced the test in selected sites in Europe. As of the fall of 2009, the PROGENSA® PCA3 was available from over 30 sites in Europe and the Middle East. On April 29, 2009, DiagnoCure and Gen-Probe executed an amendment to their 2003 license agreement, establishing new FDA submission milestones and key distribution arrangements to leverage the full market potential of the PCA3-based test for prostate cancer in the United States, Europe and around the world. Pursuant to the amendment, Gen-Probe acquired on May 7, 2009, 4.9 million DiagnoCure Series A Convertible Preferred Shares for US\$5.0 million. In addition, Gen-Probe committed to make annual payments of US\$500,000 to DiagnoCure until specific milestones are met.

On April 30, 2007, DiagnoCure secured from Targeted Diagnostics & Therapeutics, Inc. (TDT) the exclusive worldwide diagnostic rights to the GCC marker and its potential use in two high-value molecular tests for colorectal cancer. In 2008, after completing the development of one of the GCC diagnostic applications, the

Company launched its Previstage™ GCC Colorectal Cancer Staging Test from its CLIA-certified laboratory in West Chester, PA.

On August 16, 2007, DiagnoCure announced it had acquired Catalyst Oncology, Inc. of Worcester, MA, and its lead proprietary prognostic tests for breast, colon and potentially other cancers. The terms of the agreement provided for an upfront payment of approximately US\$3 million comprised of cash and DiagnoCure shares followed by potential future payments related to the achievement of specific milestones.

## **2009 Highlights**

### **Progress of the Previstage™ GCC Colorectal Cancer Staging Test**

The Company presented its proprietary laboratory-developed test, the Previstage™ GCC Colorectal Cancer Staging Test, at the Gastrointestinal Cancers Symposium of the American Society of Clinical Oncology (ASCO), held in January 2009 in San Francisco. In conjunction with this annual symposium, DiagnoCure was selected to provide an educational grant to an Independent Satellite Symposium, “*Molecular Markers and Prognosis of Patients with Colorectal Cancer*”. An independent panel of three key colorectal cancer opinion leaders, Dr. Edith P. Mitchell (Thomas Jefferson University), Dr. Stanley Hamilton (University of Texas M.D. Anderson Cancer Center) and Dr. Daniel Sargent (Mayo Clinic), reviewed different markers for the prognosis of colorectal cancer patients, including the GCC marker.

On February 18, 2009, the *Journal of the American Medical Association (JAMA)*, published positive results from a major prospective 5-year multicenter study of 425 enrolled patients demonstrating that guanylyl cyclase C (GCC), DiagnoCure’s marker, is the strongest independent predictor of colorectal cancer recurrence in patients considered low risk by current assessment methods. The study was conducted by investigators from Thomas Jefferson University, with contributions from McGill University, the Fox Chase Cancer Center and others. The study was conducted on a group of 257 colorectal cancer patients who were thought to have a lower risk of recurrence according to histopathology (stage I and II patients). When GCC was considered with other factors, patients whose nodes were GCC positive were 4.7 times more likely to develop disease recurrence than those whose nodes were GCC negative. In fact, patients with GCC positive nodes had a risk of recurrence comparable to that of patients considered higher risk by histopathology (stage III).

On October 5, 2009, the Company signed an exclusive agreement with a new partner, Lab21, a global provider of diagnostic products and services, for the promotion, marketing and selling of its Previstage™ GCC Colorectal Cancer Staging Test in the United Kingdom and Ireland. Lab21 now offers the Previstage™ GCC test as part of its oncology testing services.

### **Progress of the PCA3 Test**

On April 29, 2009, DiagnoCure and Gen-Probe executed an amendment to their 2003 license agreement, establishing new FDA submission milestones and key distribution arrangements to leverage the full market potential of the PCA3-based test for prostate cancer in the United States, Europe and around the world. Pursuant to the amendment, Gen-Probe acquired, on May 7, 2009, 4.9 million DiagnoCure Series A Convertible Preferred Shares for US\$5.0 million. As part of the contract amendment, Gen-Probe will make annual payments of US\$500,000 to DiagnoCure until specific milestones are met. Half of the amounts paid will be applied against future royalties payable to DiagnoCure.

Also on April 29, 2009, Gen-Probe announced that they intended to initiate before the end of the year a 500-patient multicenter clinical study designed to secure regulatory approval from the FDA, which would

allow them to fully promote and sell the PCA3 test in the United States. On August 27, 2009, Gen-Probe announced the beginning of this clinical trial, which is expected to take one year.

## Overall Performance

During 2009, DiagnoCure continued to move forward with its business plan and met its stated milestones for the year to fulfil its mission to be the leading developer and provider of high-value diagnostics for the detection and management of cancer.

To this end, the Company started the commercialization of its Previstage™ GCC Colorectal Cancer Staging Test in the United States through its U.S. CLIA laboratory. The Company also initiated its reimbursement process and received positive responses from insurance companies. On February 18, 2009, the *Journal of the American Medical Association (JAMA)*, published positive results from a major prospective 5-year multicenter study of 425 enrolled patients demonstrating that guanylyl cyclase C (GCC), DiagnoCure's marker, is the strongest independent predictor of colorectal cancer recurrence in patients considered low risk by current assessment methods. Last October, the Company signed an exclusive agreement with a new partner, Lab21, for the promotion, marketing and selling of the Previstage™ GCC Colorectal Cancer Staging Test in the United Kingdom and Ireland.

DiagnoCure executed with Gen-Probe an amendment to their 2003 license agreement, establishing new FDA submission milestones and key distribution arrangements to leverage the full market potential of the PCA3-based test for prostate cancer in the United States, Europe and around the world. Following this agreement, on August 27, 2009, Gen-Probe, confirmed the beginning of a U.S. clinical study intended to secure U.S. regulatory approval of the PROGENSA® PCA3 test.

## 2010 Outlook

In fiscal year 2010, DiagnoCure intends to further its commercialization efforts in support of the Previstage™ GCC Colorectal Cancer Staging Test. In particular, the Company will seek potential partners, alliances and distributorships to further leverage its commercial strength, expand the reimbursement coverage by third party payers, and advance additional clinical studies to further demonstrate the clinical utility of the test. The Company will continue to manage prudently its cash reserve.

DiagnoCure will also pursue the development of its proprietary pipeline, notably by internal research and by engaging with potential partners that have the appropriate resources and market reach.

With regard to the PROGENSA® PCA3 test, it is expected that Gen-Probe will complete in 2010 its one year clinical study aimed at securing FDA approval, continue to expand its market penetration outside of the U.S., and report on additional studies.

## Operating Results of 2009

Total revenues for 2009 were \$1,615,667 compared with \$1,995,910 for 2008. In 2009, royalty revenues amounted to \$528,480 compared with \$262,387 for 2008. Royalties revenues from Gen-Probe increased by 70% or \$182,740, from \$262,387 to \$445,127 for 2009. This increase is mostly attributable to the sales of PROGENSA® PCA3 in Europe and of the PCA3 ASRs in the United States, by Gen-Probe. Also in 2009, DiagnoCure recorded royalties of \$83,353 from Scimedx, related to ImmunoCyt™ / uCyt+™. Direct sales of DiagnoCure's bladder cancer test, ImmunoCyt™ / uCyt+™, were \$44,827 for 2009 compared with \$343,750 for 2008. These 2009 ImmunoCyt™ / uCyt+™ sales represent the last direct sales as Scimedx is now taking the lead and paying royalties to DiagnoCure. Also, DiagnoCure sold clinical samples to Gen-Probe in support of their prostate cancer testing R&D, for an amount of \$56,099 in 2009

compared with \$180,814 for 2008. In the second quarter, DiagnoCure stopped selling clinical samples to Gen-Probe. Pursuant to the amended agreement signed with Gen-Probe on April 29, 2009, DiagnoCure recorded a portion of the contractual annual payment, that is, \$440,127 for 2009. Also in 2009, DiagnoCure received reimbursement on sales of its Previstage™ GCC Colorectal Cancer Staging Test for an amount of \$41,711.

Interest income decreased by \$705,821 to \$503,138 for 2009 compared with \$1,208,959 for 2008. The decrease is attributable to DiagnoCure's use of fund to finance the operating activities and to lower interest rates on its investments.

Cost of sales decreased by \$268,490, from \$322,775 for 2008 to \$54,285 for 2009. This decrease is related to the end of direct ImmunoCyt™ / uCyt+™ sales by DiagnoCure as stated above and to lower sample sales. The cost of sales related to the Previstage™ GCC Colorectal Cancer Staging Tests reimbursed was \$27,164 for 2009.

Operating expenses decreased from \$15,597,476 for 2008 to \$14,426,437 for 2009, a decrease of \$1,171,039. This decrease reflects the impact of the workforce reduction in November 2008 and the reduction in R&D expenses related to the completion of the Previstage™ GCC Colorectal Cancer Staging Test. The decrease is offset by a loss \$434,927 on foreign exchange, related to conversion in C\$ of the cash and investments the Company held in US\$ at the end of the fiscal year, and to the issue expenses of \$309,184 related to the June 2009 public offering. The Company maintains U.S. denominated liquidities in order to finance its U.S. activities expenses. Without these two items, the total expenses would have decreased by \$1,936,625. Total operating expenses decreased primarily as a result of the following:

- ▶ Research and development expenses, net of investment tax credits, decreased by \$1,260,096, from \$6,660,778 for 2008 to \$5,400,682 for 2009. The decrease in research and development expenses is attributable to the impact of the workforce reduction in November 2008 and the reduction in R&D expenses related to the completion of the Previstage™ GCC Colorectal Cancer Staging Test.
- ▶ Selling and business development expenses increased by \$297,255, from \$2,931,991 for 2008 to \$3,229,246 for 2009. This increase is attributable to the Company's U.S. sales and marketing initiatives to promote and offer the Previstage™ GCC Colorectal Cancer Staging Test.
- ▶ General and administrative expenses decreased by \$238,634, from \$3,218,005 for 2008 to \$2,979,371 for 2009. This decrease is mostly the result of lower salary and bonus expenses, as well as lower hiring expenses since our U.S. laboratory is now fully staffed.
- ▶ Stock-based compensation expenses, a non-cash charge, decreased by \$528,053, from \$1,119,639 for 2008 to \$591,586 in 2009. This decrease is attributable to the lower value of the options granted during the year. The decrease also reflects the end of the charges recognition associated to previously granted options.
- ▶ Loss on foreign exchange increased by \$456,402 from a gain of \$21,475 in 2008 to a loss of \$434,927 for 2009. This increase is attributable to conversion in C\$ of the cash and investments the Company held in US\$ at the end of the quarter. The Company maintains cash and investments in U.S. dollars in order to finance its U.S. activities.

Based on the above, for 2009, DiagnoCure recorded a net loss of \$12,865,055 or \$0.30 per share, compared with \$13,833,978 or \$0.33 per share for 2008. These results are substantially in line with Management's expectations and reflect activities undertaken during the year, in line with the Company's plans and on-going commitment to develop high-value diagnostic tests for the detection and management of cancer. At the end of the current fiscal year, cash, short-term and long-term investments

stood at \$14,554,889, down from \$20,130,705 as of October 31, 2008. This decrease of \$5,575,816 is due to the use of liquidity to finance the operating activities for fiscal 2009 and is net of \$5,857,866 generated from financing activities, mainly related to the issuance of 4.9 million Series A Convertible Preferred Shares to Gen-Probe as per the agreement signed on April 29, 2009. Management is satisfied that it has adequate cash resources to finance the Company's operations, and will monitor its cash levels.

## Selected Annual Information

(Data shown below come from the audited consolidated financial statements of the Company)

	2009	2008	2007
	\$	\$	\$
Sales	143,922	524,564	432,763
Revenue under research and license agreement	968,607	262,387	1,839,783
Interest	503,138	1,208,959	1,194,879
Total revenues	1,615,667	1,995,910	3,467,425
Cost of sales	54,285	322,775	264,285
Operating expenses (before stock-based compensation, restructuring charges and income taxes)	13,834,851	14,422,803	9,545,873
Stock-based compensation	591,586	1,119,639	1,550,801
Restructuring charges (note 6)	—	55,034	1,262,685
Operating expenses before income taxes	14,426,437	15,597,476	12,359,359
Net loss before discontinued operations and income taxes	(12,865,055)	(13,924,341)	(9,156,219)
Future income taxes	—	90,363	—
Net loss	(12,865,055)	(13,833,978)	(9,156,219)
Basic and diluted loss per share	(0.30)	(0.33)	(0.24)
Weighted average number of common shares outstanding	42,849,592	42,272,320	38,422,096

## Total Assets and Shareholders' Equity

Total assets amounted to \$26,350,256 as of October 31, 2009, compared with \$33,146,066 as of October 31, 2008. The book value per Common Share was \$0.54 as of October 31, 2009 compared with \$0.69 per Common Share as of October 31, 2008.

(Data shown below come from the audited consolidated financial statements of the Company)

	2009	2008	2007
	\$	\$	\$
Total assets	26,350,256	33,146,066	43,585,440
Shareholders' equity	23,224,245	29,639,848	40,191,471
Number of common shares outstanding	42,957,475	42,794,465	41,718,463

## Cash Position and Financing Sources

Cash flows required from operating activities for 2009 amounted to \$11,282,350 compared with \$11,064,611 required for 2008. This increase of \$217,739 is attributable to the difference in non-cash working capital, mostly due to the decrease in accounts payable related to the restructuring provision. Investment activities generated cash flows of \$9,340,174 for 2009 compared with \$11,153,886 for 2008. In 2009, acquisition of tangible and intangible capital assets amounted to \$151,332 compared with \$1,852,821 for 2008. This decrease is mostly attributable to intellectual properties milestones paid in 2008 and to less acquisition of property plant and equipment as the Company's U.S. laboratory is now operational. Financing activities, primarily from the issuance of Series A Convertible Preferred Shares relative to the agreement signed with Gen-Probe, generated cash flows of \$5,857,866 for 2009 compared with \$155,566 for 2008.

DiagnoCure will continue to invest its cash reserve in liquid, high-grade investments, guaranteed by the government. The financial crisis has had no impact on the Company's investments in 2009, except that the decrease in interest rates has resulted in lower revenues for the Company. Furthermore, in the coming months, we could see the same impact on the interest revenue that will be generated by these investments, as a result of the decrease in the key interest rate of the Bank of Canada in 2009.

DiagnoCure's funding needs may vary depending on a number of factors. The Company's funding requirements for the next years will depend on its ability to generate revenues from sales and royalties, and to conclude strategic alliances and development partnerships, as well as on the progress resulting from these agreements.

## Cash Flows

(Data shown below come from the audited consolidated financial statements of the Company)

	2009 \$	2008 \$	2007 \$
Cash flows related to operating activities	<b>(11,282,350)</b>	(11,064,611)	(5,628,014)
Cash flows related to investing activities	<b>9,340,174</b>	11,153,886	(17,383,719)
Cash flows related to financing activities	<b>5,857,866</b>	155,566	23,483,391

## Issued and Outstanding Share Capital

As of January 14, 2010, the Company had 42,957,475 common shares issued and outstanding, 4,900,000 Series A Convertible Preferred Shares and 2,742,934 stock options granting the right to acquire an equal amount of common shares.

## Results of the Fourth Quarter 2009

Total revenues for the fourth quarter of 2009 were \$351,924 compared with \$502,272 for the fourth quarter of 2008. In the fourth quarter of 2009, royalty revenues amounted to \$94,731 compared with \$110,770 for the corresponding period of 2008. Royalty revenues from Gen-Probe decreased by \$48,441, from \$110,770 to \$62,329 for the fourth quarter of 2009. This decrease is mostly attributable to the modification in our revenue recording to better align our revenue recognition period with Gen-Probe's. As such, to account for this change going forward, only two months of royalties have been recorded for the fourth quarter of 2009 compared with three months of royalties for the same period in 2008. Also in the fourth quarter of 2009, DiagnoCure recorded royalties of \$32,402 from Scimedx related to ImmunoCyt™ / uCyt+™, compared with \$65,402 of direct sales of ImmunoCyt™ / uCyt+™ for the same period of 2008. DiagnoCure ceased selling directly its bladder cancer test, ImmunoCyt™ / uCyt+™, as Scimedx is now taking the lead and paying royalties to DiagnoCure. Also in the second quarter of 2009, DiagnoCure sold its last clinical samples to Gen-Probe in support of their prostate cancer testing R&D. For the fourth quarter of 2008, DiagnoCure had sold clinical samples to Gen-Probe for an amount of \$58,441. Pursuant to the amended agreement signed with Gen-Probe on April 29, 2009, DiagnoCure recorded a portion of the contractual annual payment, that is, \$145,960 for the fourth quarter of 2009. Also during the quarter, DiagnoCure received reimbursement for the sales of the Previstage™ GCC Colorectal Cancer Staging Test for an amount of \$14,769.

Interest income decreased by \$172,480, to \$95,179 for the fourth quarter of 2009 compared with \$267,659 for the fourth quarter of 2008. The decrease is attributable to DiagnoCure's use of fund to finance its operating activities and the lower interest rates on its investments.

Cost of sales decreased by \$70,214 from \$78,694 for the fourth quarter of 2008 to \$8,480 for the same quarter of 2009. This decrease is related to the end of direct ImmunoCyt™ / uCyt+™ sales by DiagnoCure and to the end of prostate cancer related sample sales during the second quarter as stated above. The cost of sales for this quarter represents the cost related to the Previstage™ GCC Colorectal Cancer Staging Tests reimbursed.

Operating expenses decreased by \$1,058,800, from \$4,082,262 for the fourth quarter of 2008 to \$3,023,462 for the fourth quarter of 2009. This decrease reflects the impact of workforce reduction in November 2008 and the reduction in R&D expenses related to the completion of the Previstage™ GCC Colorectal Cancer Staging Test.

Based on the above, for the fourth quarter of 2009, DiagnoCure recorded a net loss of \$2,680,018 or \$0.07 per share, compared with \$3,568,321 or \$0.09 per share, for the same period of 2008. These results are substantially in line with Management's expectations and reflect activities undertaken during this quarter, in line with the Company's plans and on-going commitment to develop high-value diagnostic tests for the detection and management of cancer.

### Summary of Quarterly Results (Unaudited)

	Quarters ended 2009			
	January 31	April 30	July 31	October 31
Total revenues	400,123	467,152	396,468	351,924
Cost of sales	12,832	16,422	16,551	8,480
Operating expenses	3,858,709	3,101,476	4,442,790	3,023,462
Net loss	(3,471,418)	(2,650,746)	(4,062,873)	(2,680,018)
Basic and diluted net loss per share	(0.08)	(0.06)	(0.09)	(0.07)

	Quarters ended 2008			
	January 31	April 30	July 31	October 31
Total revenues	491,455	516,109	486,074	502,272
Cost of sales	69,790	86,750	87,541	78,694
Operating expenses	3,106,974	3,801,733	4,606,507	4,082,262
Net loss	(2,685,309)	(3,372,374)	(4,207,974)	(3,568,321)
Basic and diluted net loss per share	(0.06)	(0.08)	(0.10)	(0.09)

### Off-Balance Sheet Arrangements

During the year ended October 31, 2007, the Company entered into license agreements with third parties regarding certain intellectual property rights. Those agreements were for an initial term of 10 years. The Company agreed to pay royalties on all products sold derived from the underlying technologies and milestone payments after achievement of the respective milestones, if applicable. The royalties that the Company might have to pay represent 5% to 10% of net sales and 20% of sublicense revenues. The total of the milestone payments that may have to be paid by the Company over the next years is \$2,125,000.

The Company periodically enters into research agreements or strategic alliances with third parties that include indemnification provisions that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is not limited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the intellectual property indemnification obligations

prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in these consolidated financial statements with respect to these indemnification obligations.

As at October 31, 2009, DiagnoCure had not entered into any off-balance sheet arrangement except for premises rental contracts described in the "Contractual Obligations" section of the present report.

### Use of Proceeds from July 2004 Financing

In July 2004, the Company raised, by way of short form prospectus, net proceeds of \$22,332,108 from the issuance of 5 million common shares, at \$4.75 per share. At that time, estimates were made as to the use of these proceeds. As at October 31, 2009, approximately \$19.15 million of funds from the July 2004 public offering have been spent on specific projects and for general corporate purposes listed in the table below. Since cash flows of the Company are derived from numerous sources, in order to determine how the proceeds of the public offering are spent and allocated, certain assumptions were required. Those assumptions are as follows:

- ▶ Day-to-day administrative and operating expenses for the Company are funded from the license payments that DiagnoCure receives from Gen-Probe, interest income and gross margin realized on the Company's sales.
- ▶ Additional funds over those required to fund items above are taken from the proceeds of the July 2004 public offering.

Based on these assumptions, a summary of the "Use of proceeds" from the July 2004 public offering is the following:

Description of "Use of Proceeds"	Estimated total use of proceeds as disclosed at time of July 2004 public offering	Amounts spent as at October 31, 2009	Amounts spent for the twelve-month period ended October 31, 2009
Improve the uPM3 <sup>TM</sup> prostate cancer test, develop complementary applications and examine the therapeutic potential of the PCA3	\$4.00 million	\$3.90 million	—
Support the commercialization and expand the automation of ImmunoCyt <sup>TM</sup> / uCyt+ <sup>TM</sup> bladder cancer test	\$2.50 million	\$2.60 million	—
Advance the development of lung cancer and kidney cancer tests and initiate the development of other cancer tests	\$10.50 million	\$8.15 million	\$2.18 million
Acquire complementary technologies and uses for other general corporate purposes	\$5.33 million	\$4.50 million	—

With this financing, the Company has completed the uPM3<sup>TM</sup> prostate cancer test and has continued the advancement of other cancer tests. In 2006, the Company elected to cease its activities with respect to the automation of ImmunoCyt<sup>TM</sup> / uCyt+<sup>TM</sup> and in 2008 has completed a divestment agreement with Scimedx. The Company is now receiving royalties on the ImmunoCyt<sup>TM</sup> / uCyt+<sup>TM</sup> product sales realized by Scimedx.

## Use of Proceeds from April 2007 Financing

In April 2007, the Company raised, by way of short form prospectus, net proceeds of \$23,353,098 from the issuance of 5.80 million common shares, at \$4.30 per share. At that time, estimates were made as to the use of these proceeds. As at October 31, 2009, approximately \$22.20 million of funds from the April 2007 public offering have been spent on acquiring or in-licensing additional cancer biomarkers and for product development purposes, as described:

Description of "Use of Proceeds"	Amount spent as at October 31, 2009
Acquire and integrate or partner with one or more reference laboratories	\$4.90 million
Expand the product portfolio	\$3.90 million
Acquire or in-license additional cancer biomarkers and for product development purposes	\$13.40 million

## Use of Estimates

In preparing its consolidated financial statements, Management is required to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In Management's opinion, the consolidated financial statements have been prepared using careful judgment within the framework of the accounting policies described in Note 2 of the accompanying notes to the consolidated financial statements. The Company periodically evaluates its estimates and assumptions based on its past experience and other pertaining factors. The following paragraphs give details on the use of estimates and hypotheses used.

## Investment Tax Credits

The Company incurred research and development expenses, which are eligible for investment tax credits. These credits, treated as a reduction to research and development expenses, amounted to \$420,021 in fiscal year 2009 (\$486,149 in fiscal year 2008) and are based on Management's estimates of amounts to be recovered. While these amounts are subject to review by tax authorities, Management believes that its estimate of these amounts is reasonable.

## Impairment of Long-Term Assets

Long-lived assets and certain identifiable intangibles and intellectual properties are regularly reviewed for impairment by Management whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value (net recoverable value). If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value.

## Stock-Based Compensation Plan

The Company determines the fair value of direct awards of stock options made to its employees and directors. The fair value of these options is estimated at the date of grant using the Black-Scholes option pricing model with assumptions for the risk-free interest rates, dividend yields, expected volatility of the market price of the Company's common shares and the expected life of the options.

## Derivatives

DiagnoCure is not party to hedging arrangements with regard to foreign exchange risk or any other similar risks.

## Contractual Obligations

The Company has incurred contract agreements for the rental of premises for the following amounts:

Contractual obligations	Required Payments			
	Total	Year 1	Years 2 and 3	Years 4 and 5
Lease agreements	\$1,676,147	\$563,313	\$609,737	\$503,096

DiagnoCure currently leases 32,808 sq. ft., in a building where its head office and research and development laboratories are located under a lease expiring in 2011. The annual payment for the coming year under this lease agreement amounts to \$328,088.

On December 5, 2007, DiagnoCure signed a lease for 11,329 sq. ft., in a building where its U.S. clinical laboratory activities are located, under a lease expiring in 2015. The annual payment for the coming year under this lease agreement amounts to \$235,225.

During the year ended October 31, 2007, the Company entered into license agreements with third parties regarding certain intellectual property rights. Those agreements were for an initial term of 10 years. The Company agreed to pay royalties on all products sold derived from the underlying technologies and milestone payments after achievement of the respective milestones, if applicable.

## New Accounting Policies

### A) Adopted in 2009 and 2008

#### 2009

##### *Goodwill and intangible assets*

During the year, the Company adopted Section 3064 "Goodwill and Intangible Assets". The new section states that upon their initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the recognition criteria. As for subsequent measurement of intangible assets, goodwill and disclosure, Section 3064 carries forward the requirements of the old Section 3062 "Goodwill and Intangible Assets". The adoption of these recommendations did not have any material effect on the Company's consolidated financial statements.

##### *Financial instruments*

During the year, the Company adopted EIC-173 "Credit Risk and the Fair value of Financial Assets and Financial Liabilities". Under this new standard, 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. The adoption of these recommendations did not have any material effect on the Company's consolidated financial statements.

In June 2009, the AcSB issued amendments to Section 3862 "Financial Instruments – Disclosures". These amendments were effective for the Company commencing November 1, 2008, and introduced a three-level fair value hierarchy that prioritizes the quality and reliability of information used in estimating the fair value of instruments. The fair values for the three levels are based on:

- ▶ Level 1 – quoted prices in active markets
- ▶ Level 2 – models using observable inputs other than quoted market prices
- ▶ Level 3 – models using inputs that are not based on observable market data

### ***General standards of financial statement presentation***

CICA 1400 “General Standards of Financial Statement Presentation” was amended to include requirements to assess and disclose an entity’s ability to continue as going concern.

The adoption of these new sections had no impact on the Company’s consolidated financial statements.

## **2008**

### ***Capital***

Section 1535 “Capital Disclosures” establishes standards for disclosing information about an entity’s capital and how it is managed. These standards require entity to disclose the following:

- ▶ Its objectives, policies and processes for managing capital;
- ▶ Whether during the year it complied with any externally imposed capital requirements to which it is subject;
- ▶ When the entity has not complied with such requirements, the consequences of such non-compliance.

### ***Financial instruments***

Section 3862 “Financial Instruments – Disclosures” modifies the disclosure requirements for financial instruments that were included in Section 3861 “Financial Instruments – Disclosure and Presentation”. The new standards require entities to provide disclosures in their financial statements that enable users to evaluate:

- ▶ the significance of financial instruments for the entity’s financial position and performance;
- ▶ the nature and extent of risks arising from financial instruments to which the entity is exposed during the year and at the balance sheet date, and how the entity manages those risks.

Section 3863 “Financial Instruments – Presentation” carries forward the presentation requirements of the old Section 3861 “Financial Instruments – Disclosure and Presentation”, which remains unchanged.

With the exception of the disclosures required under the aforementioned sections, the adoption of these new standards had no material effect on the Company’s consolidated financial statements.

## **B) Recently Issued**

In January 2009, the AcSB released Section 1582 “Business Combinations”, Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-Controlling Interest”, which replace Section 1581 “Business Combinations” and Section 1600 “Consolidated Financial Statements”.

### ***Business combinations***

Section 1582 provides the Canadian equivalent to IFRS 3 “Business Combinations”. The new recommendations require measuring business acquisitions at the fair value of the acquired business, including the measurement at fair value of items such as non-controlling interest and contingent payment considerations. Also, the previously unrecognized deferred tax assets related to the acquired subsequent to the business combination are recognized in the consolidated statements of operations rather than as a reduction of goodwill. In addition, business acquisition related costs are expensed as incurred.

The adoption of Section 1582 could have a material effect on the accounting for business combinations that will occur subsequent to the adoption of this standard. The Company will adopt this standard on November 1, 2009.

## Recent Accounting Pronouncements

### International financial reporting standards

On February 13, 2008, the Accounting Standards Board confirmed the date of the changeover from GAAP to International Financial Reporting Standards (IFRS). Canadian publicly accountable enterprises must adopt IFRS for the interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company's IFRS changeover date will be November 1, 2011.

The Company plans to setup a project structure to achieve the changeover of its consolidated financial statements to IFRS in fiscal 2010. With the assistance of its external auditor, the Company will analyze, recommend accounting policy choices and implements each IFRS standards. The CFO and the audit committee will approve accounting policy choices and make sure that information technology, internal control, contractual and any other adjustments are made.

The Company developed a work plan which phases are outlined in the following tables, with actions, timelines and progress.

#### Phase 1: Preliminary study and diagnostic

Actions	<ol style="list-style-type: none"> <li>1. Identification of the IFRS standards that will require changes with regard to measurement in the consolidated financial statements and disclosure.</li> <li>2. Rank of standards based on their anticipated impact on the Company's consolidated financial statements and the effort their implementation will require.</li> </ol>
Timeline	End of 2010 fiscal year.
Progress	Not yet started.

#### Phase 2: Standards analysis

Actions	<ol style="list-style-type: none"> <li>1. Analysis of the differences between GAAP and IFRS.</li> <li>2. Selection of the accounting policies that the Company will apply on an ongoing basis.</li> <li>3. Company's selection of IFRS 1 exemptions at the date of transition. Calculation of the quantitative impact on the consolidated financial statements. Disclosure analysis.</li> <li>4. Preparation of draft consolidated financial statements and notes. Identification of collateral impact in the following areas: <ul style="list-style-type: none"> <li>▶ Information technology</li> <li>▶ Internal control over financial reporting</li> <li>▶ Disclosure controls and procedures</li> <li>▶ Contracts</li> <li>▶ Compensation</li> <li>▶ Taxation</li> <li>▶ Training</li> </ul> </li> </ol>
Timeline	End of 2011 fiscal year.
Progress	Not yet started.

### Phase 3: Implementation

Actions	<ol style="list-style-type: none"><li>1. Preparation of the opening balance sheet at the date of transition.</li><li>2. Compilation of the comparative financial data.</li><li>3. Production of the interim consolidated financial statements and the associated disclosure.</li><li>4. Production of the annual consolidated financial statements and the associated disclosure.</li><li>5. Implementation of changes regarding collateral impact.</li></ol>
Timeline	<ul style="list-style-type: none"><li>▶ At the end of fiscal 2011, opening balance sheet, comparative financial data under IFRS and changes regarding collateral impacts will be completed.</li><li>▶ In fiscal 2012, the Company will produce interim and annual consolidated financial statements and disclosure in accordance with IFRS.</li></ul>
Progress	Not yet started.

Throughout the IFRS transition project, the Company will provide update reports on the work plan. The Company will also explain the main differences between the existing accounting policies and those that will be implemented under IFRS (both narrative and quantitative information), as well as the selection of IFRS 1 exemptions available at the date of transition.

#### Procedures and Controls Regarding Disclosure

The President and Chief Executive Officer, and the Senior Vice President and Chief Financial Officer of the Company are responsible for the implementation and maintenance of disclosure controls and procedures and of the internal control over financial reporting, as provided for in Regulation 52-109 issued by the Canadian Securities Administrators. They are assisted in this task by the Disclosure Committee, which is comprised of members of the Company's senior management.

An evaluation was completed under their supervision in order to measure the effectiveness of the controls and procedures and of the internal control over financial reporting, relating to the preparation of disclosure documentation, including this Management's Discussion and Analysis, the Annual Report, the Annual Information Form and the Management Proxy Circular. Based upon this evaluation, the President and Chief Executive Officer, and the Senior Vice President and Chief Financial Officer of the Company concluded that disclosure controls and procedures and the internal control over financial reporting were effective as at the end of the fiscal year ended October 31, 2009. More specifically the design of these controls and procedures provides reasonable assurance that important information relating to the Company, including its consolidated subsidiaries, is communicated to them in a timely manner for the preparation of this disclosure documentation.

Furthermore, the design of the internal control over financial reporting provides reasonable assurance that the Company's financial information is reliable and that its financial statements are prepared for external purposes in accordance with Canadian GAAP.

#### Risk Factors

The Company's activities are subject to some risk factors that generally affect biotechnology companies. The profitability of the Company will depend on its ability to successfully develop its products and technologies, to preserve its intellectual property rights, to maintain its highly qualified personnel, to conclude strategic alliances, research and development partnerships, strategic out-licensing agreements, to obtain satisfactory results as regards clinical studies and to obtain regulatory approvals required to commercialize its products. These activities require important financial investments. Therefore, the Company's ability to obtain necessary liquidities to finance its activities is essential to ensure future

success and is as such a risk factor. The reader is referred to the applicable general risk and uncertainties described in DiagnoCure's most recent Annual Information Form under the heading "Risk Factors".

### **Cautionary Statement**

Management's comments and analysis are intended to facilitate understanding of the audited consolidated financial statements and accompanying notes and should therefore be read in conjunction with that information. The comments and analysis may include objectives, projections, estimates, expectations and forecasts of the Company or Management that are forward-looking. By their very nature, forward-looking statements are based on expectations and hypothesis and also involve risks and uncertainties, known and unknown, many of which are beyond DiagnoCure's control. As a result, readers are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements regarding the outcome of research and development projects and future revenues are based on Management's expectations and there was, to the knowledge of Management, no event or circumstance in the fiscal year 2009 likely to cause actual results to differ materially from these forward looking-statements. In addition, the reader is referred to the applicable general risks and uncertainties described in DiagnoCure's most recent Annual Information Form under the heading "Risk Factors". DiagnoCure undertakes no obligation to publicly update or revise any forward-looking statements contained herein unless required by the applicable securities laws and regulations.

Further information about DiagnoCure may be obtained on the Company's web site at [www.diagnocure.com](http://www.diagnocure.com). Additional information, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

Québec, Canada

January 14, 2010

(signed)

**John C. Schafer**  
President and Chief Executive Officer

(signed)

**Jean-François Bureau**  
Senior Vice President and Chief Financial Officer

## Management's Responsibility for Financial Reporting

The consolidated financial statements of DiagnoCure, Inc. and all the information in this annual report are the responsibility of Management and have been approved by the Board of Directors.

It is Management's responsibility to make sound and informed decisions to ensure the application of the appropriate accounting methods and principles. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Financial information presented in this annual report is consistent with that in the consolidated financial statements.

DiagnoCure, Inc. maintains systems of internal accounting and administrative controls which, in Management's opinion, provide reasonable assurance that the financial information is accurate, relevant and reliable and that the Company's business is conducted efficiently and in an orderly manner.

The Board of Directors ensures that Management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility through its Audit and Risk Management Committee. The Audit and Risk Management Committee members are independent directors; they meet with Management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues to satisfy themselves that each party is properly discharging its responsibilities, and to review the consolidated financial statements and the external auditors' report.

The consolidated financial statements for the years ended October 31, 2009 and 2008, have been audited by Ernst & Young LLP, the external auditors appointed by the shareholders, in accordance with Canadian generally accepted auditing standards. Moreover, the auditors have access to the Audit and Risk Management Committee at all times.

Québec, Canada

January 14, 2010

(signed)

**John C. Schafer**  
President and Chief Executive Officer

(signed)

**Jean-François Bureau**  
Senior Vice President and Chief Financial Officer

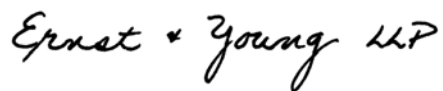
# Auditor's Report

To the Shareholders of  
**DiagnoCure, Inc.:**

We have audited the consolidated balance sheets of DiagnoCure, Inc. as at October 31, 2009 and 2008 and the consolidated statements of deficit, operations and comprehensive loss 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 October 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.



Chartered Accountants

Québec City, Canada  
December 4, 2009

<sup>1</sup>CA auditor permit no 10845

# Consolidated Balance Sheets

As at October 31

	2009 \$	2008 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	4,812,117	896,427
Temporary investments (note 6)	8,918,860	11,476,739
Accounts receivable (note 7)	235,333	352,493
Investment tax credits receivable (note 13)	906,170	486,149
Prepaid expenses	296,690	187,588
	<b>15,169,170</b>	<b>13,399,396</b>
<b>Long-term investments (note 8)</b>	<b>823,912</b>	<b>7,757,539</b>
<b>Property, plant and equipment (note 9)</b>	<b>999,876</b>	<b>1,480,888</b>
<b>Intangibles (note 10)</b>	<b>9,357,298</b>	<b>10,508,243</b>
	<b>26,350,256</b>	<b>33,146,066</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	1,965,316	2,491,289
Deferred revenues	145,766	—
Future income tax liabilities (note 14)	1,014,929	1,014,929
<b>Shareholders' equity</b>		
Capital stock (note 11)		
Common shares	92,015,103	91,885,595
Preferred shares	5,857,000	—
Contributed surplus (note 11)	7,602,811	7,069,693
Deficit	(82,250,669)	(69,315,440)
	<b>23,224,245</b>	<b>29,639,848</b>
	<b>26,350,256</b>	<b>33,146,066</b>

Commitments and guarantees (note 17)  
See accompanying notes

**On behalf of the Board:**

(signed)  
**John C. Schafer**  
Director

(signed)  
**Yves Fradet**  
Chairman of the Board

## Consolidated Statements of Deficit

For the years ended October 31

	2009	2008
	\$	\$
<b>Deficit, beginning of year</b>	<b>(69,315,440)</b>	(55,481,462)
Net loss	<b>(12,865,055)</b>	(13,833,978)
Preferred shares issue expenses <i>(note 11)</i>	<b>(70,174)</b>	—
<b>Deficit, end of year</b>	<b>(82,250,669)</b>	(69,315,440)

*See accompanying notes*

## Consolidated Statements of Operations and Comprehensive Loss

For the years ended October 31

	2009 \$	2008 \$
<b>Revenues</b>		
Sales	143,922	524,564
Cost of sales	(54,285)	(322,775)
	89,637	201,789
Revenue under research and license agreement	968,607	262,387
Interest	503,138	1,208,959
	<b>1,561,382</b>	<b>1,673,135</b>
<b>Operating expenses</b>		
Research and development expenses	5,820,703	7,146,927
Investment tax credits <i>(note 13)</i>	(420,021)	(486,149)
	5,400,682	6,660,778
Selling and business development expenses	3,229,246	2,931,991
General and administrative expenses	2,979,371	3,218,005
Stock-based compensation <i>(note 11)</i>	591,586	1,119,639
Restructuring charges <i>(note 5)</i>	—	55,034
Depreciation of property, plant and equipment	574,692	505,306
Amortization of intangibles	1,190,197	1,124,054
Gain on disposal of intangibles	—	(15,164)
Loss (gain) on foreign exchange	434,927	(21,475)
Financial expenses	25,736	19,308
	<b>14,426,437</b>	<b>15,597,476</b>
Loss before income taxes	(12,865,055)	(13,924,341)
Future income taxes	—	90,363
<b>Net loss and comprehensive loss</b>	<b>(12,865,055)</b>	<b>(13,833,978)</b>
<b>Basic and diluted net loss per share</b>	<b>(0.30)</b>	<b>(0.33)</b>
<b>Weighted average number of common shares outstanding</b>	<b>42,849,592</b>	<b>42,272,320</b>

See accompanying notes

# Consolidated Statements of Cash Flows

For the years ended October 31

	2009 \$	2008 \$
<b>OPERATING ACTIVITIES</b>		
Net loss	(12,865,055)	(13,833,978)
Adjustment for:		
Stock-based compensation	591,586	1,119,639
Depreciation and amortization	1,764,889	1,629,360
Gain on disposal of intangibles	—	(15,164)
Foreign exchange gain	(293,760)	—
Future income taxes	—	(90,363)
	<b>(10,802,340)</b>	<b>(11,190,506)</b>
Net change in non-cash working capital items	(773,770)	125,895
<b>Cash flows related to operating activities</b>	<b>(11,576,110)</b>	<b>(11,064,611)</b>
<b>INVESTING ACTIVITIES</b>		
Temporary investments	2,557,879	13,098,717
Long-term investments	6,933,627	(117,055)
Acquisition of property, plant and equipment	(112,080)	(801,449)
Acquisition of intangibles	(39,252)	(1,051,372)
Disposal of intangibles	—	25,045
<b>Cash flows related to investing activities</b>	<b>9,340,174</b>	<b>11,153,886</b>
<b>FINANCING ACTIVITIES</b>		
Issue of common shares (note 11)	71,040	155,566
Issue of preferred shares (note 11)	5,857,000	—
Preferred shares issue expenses	(70,174)	—
<b>Cash flows related to financing activities</b>	<b>5,857,866</b>	<b>155,566</b>
<b>Effect of exchange rate on cash and cash equivalents</b>	<b>293,760</b>	<b>—</b>
<b>Net increase in cash and cash equivalents for the year</b>	<b>3,915,690</b>	<b>244,841</b>
Cash and cash equivalents, beginning of year	896,427	651,586
<b>Cash and cash equivalents, end of year (note 12)</b>	<b>4,812,117</b>	<b>896,427</b>
<b>Additional information</b>		
Acquisitions of property, plant and equipment included in accounts payable and accrued liabilities	3,600	22,000

See accompanying notes

# Notes to Consolidated Financial Statements

October 31, 2009

## 1. INCORPORATION AND NATURE OF BUSINESS

The Company was incorporated on December 8, 1994, under Part 1A of the *Companies Act (Québec)*. DiagnoCure, Inc. is a biotechnology company which specializes in the development and commercialization of products relating to the diagnosis of cancer.

The Company intends to continue its research and development and marketing efforts. The Company's operations are subject to all the inherent risks related to setting up and running an emerging biotechnology company, such as successfully completing its research and development activities, marketing its products and obtaining the required financing.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Basis of financial statement presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and those of its wholly owned subsidiaries, Catalyst Oncology LP, DiagnoCure U.S. GP, 9184-6766 Québec Inc. and 9161-6722 Québec Inc. All significant intercompany transactions and balances have been eliminated upon consolidation.

### Use of estimates

The Company's consolidated financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. In preparing these consolidated financial statements, Management is required to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In Management's opinion, the consolidated financial statements have been properly prepared using careful judgment within the framework of the accounting policies summarized below.

### Cash equivalents

Cash equivalents consist of investments that are readily convertible into a known amount of cash, that are subject to minimal risk of changes in value and which have an original maturity of three months or less from the date of purchase.

### Temporary and long-term investments

Investments consisting of short-term bonds and treasury bills, are recorded at amortized cost using the effective interest rate method after their initial fair value measurement. These investments are classified as financial assets held-to-maturity.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

### Property, plant and equipment and intangibles

Property, plant and equipment and intangibles are recorded at cost and depreciation is calculated using the straight-line method over the following estimated useful lives:

#### *Property, plant and equipment*

Leasehold improvements	Lease term
Office furniture and equipment	5 years
Laboratory equipment	5 years
Computer hardware and software	3 years

#### *Intangibles*

Licenses and patents	10 years
----------------------	----------

Intangibles consist of licenses and patents relating to products under development purchased by the Company.

### Government assistance

Government assistance received in the form of grants and investment tax credits for qualifying research and development activities are applied as a reduction of the cost of the related property, plant and equipment or as a reduction of the applicable research and development expenses when there is reasonable assurance of their ultimate realization.

### Revenue recognition

The Company's product revenues for tests performed are recognized when the following criteria of revenue recognition are met: (1) persuasive evidence that an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. Criterion (2) is satisfied when the Company performs the test, generates and delivers a report to the physician. Determination of criteria (3) and (4) is based on Management's judgment regarding the nature of the fee charged for products or services delivered and the collectability of those fees. Product revenues where the criteria set forth in (1) and (2) above are met, and (3) and (4) above are not met, are recognized on a cash basis when cash is received.

The Company generally bills third-party payers for the Previstage™ GCC Colorectal Cancer Staging Test upon generation and delivery of a Previstage™ GCC Result Report to the physician. As such, the Company takes assignment of benefits and the risk of collection with the third-party payer. The Company usually bills the patient directly for amounts owed after multiple requests for payment have been denied or only partially paid by the insurance carrier. As a relatively new test, the Previstage™ GCC Colorectal Cancer Staging Test may be considered investigational by payers and not covered under their reimbursement policies. Consequently, the Company pursues case-by-case reimbursement where policies are not in place or payment history has not been established. As a result, at the time of delivery of the Previstage™ GCC Result Report to the physician, and in the absence of a reimbursement contract or sufficient payment history, collectability cannot reasonably be assured and revenues are therefore only recognized at the time cash is collected.

## **2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

### **Revenue recognition (cont'd)**

The Company recognizes revenues from research and license agreements as the contracted services are performed, in accordance with the terms of the specific agreement. Non-refundable up front and calendar payments for access to the Company's proprietary technologies in connection with the research and license agreements are recognized as revenue over the term of the related collaboration. Amounts received in advance of recognition are included in deferred revenues.

Interest income is recognized on an accrual basis.

### **Income taxes**

The Company recognizes taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on the temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities. These future tax assets and liabilities are measured using tax rates that are expected to apply when such tax assets or liabilities are either realized or settled. A write-down allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

### **Research and development**

Research expenses are charged to consolidated income as incurred. Development expenses are charged to consolidated income as incurred unless a development project meets the criteria under Canadian generally accepted accounting principles in respect of deferral and amortization. To date, the Company has not deferred any such development expenses.

### **Foreign currency translation**

The consolidated financial statements are denominated in Canadian dollars. The temporal method is used for accounts in foreign currencies as well as for the integrated subsidiaries. Under this method, monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year-end exchange rates and non-monetary assets and liabilities are translated at the exchange rates prevailing when the assets were acquired or liabilities were incurred. Revenue and expenses (other than depreciation and amortization, which are translated at the rate applicable to the corresponding assets) are translated at the average rate of exchange for the period. Gains and losses on translation of foreign currencies are included in the consolidated statement of operations in the current period.

### **Loss per share**

Basic loss per share is calculated using the weighted average number of outstanding common shares during the year. Diluted loss per share is calculated using the treasury stock method, giving effect to the exercise of all dilutive securities. The treasury stock method assumes that proceeds from the exercise of options are used to purchase common shares at the average market price during the period. The convertible preferred shares and the stock options were not included in the diluted loss per share calculation because the Company is in a loss position, and the inclusion of these instruments would be anti-dilutive.

## **2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

### **Impairment of long-lived assets**

Long-lived assets and certain identifiable intangibles are reviewed for impairment by Management whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value (net recoverable value). If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value.

### **Stock-based compensation**

The fair value of each option granted to employees and directors, is estimated on the date of the grants using the Black-Scholes option pricing model and is amortized as a compensation expense over the graded vesting schedule of the granted option which is three years as if the grants were a series of awards rather than a single award. These expenses are included in the stock-based compensation expense and credited to the contributed surplus. When options are exercised, the proceeds received by the Company, together with the fair value amount recorded in contributed surplus, are credited to capital stock.

### **Disposal of long-lived assets and discontinued operations**

Assets classified as held for sale are measured at the lower of carrying value and fair value less disposal costs. Assets classified as held for sale are not to be amortized while classified as such. The results of operations of a component of the Company that has been disposed of by either sale or abandonment are reported as discontinued operations and comprise operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the Company.

## **3. NEW ACCOUNTING POLICIES**

### **A) Adopted in 2009 and 2008**

#### **2009**

#### ***Goodwill and intangible assets***

During the year, the Company adopted Section 3064 "Goodwill and Intangible Assets". The new section states that upon their initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the recognition criteria. As for subsequent measurement of intangible assets, goodwill and disclosure, Section 3064 carries forward the requirements of the old Section 3062 "Goodwill and Other Intangible Assets". The adoption of these recommendations did not have any material effect on the Company's consolidated financial statements.

#### ***Financial instruments***

During the year, the Company adopted EIC-173 "Credit Risk and the Fair value of Financial Assets and Financial Liabilities". Under this new standard, 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. The adoption of these recommendations did not have any material effect on the Company's consolidated financial statements.

### 3. NEW ACCOUNTING POLICIES (Cont'd)

#### A) Adopted in 2009 and 2008 (Cont'd)

##### 2009 (cont'd)

##### *Financial instruments (cont'd)*

In June 2009, the AcSB issued amendments to Section 3862 "Financial Instruments – Disclosures". These amendments were effective for the Corporation commencing November 1, 2008 and introduced a three-level fair value hierarchy that prioritizes the quality and reliability of information used in estimating the fair value of instruments. The fair values for the three levels are based on:

- ▶ Level 1 – quoted prices in active markets
- ▶ Level 2 – models using observable inputs other than quoted market prices
- ▶ Level 3 – models using inputs that are not based on observable market data

##### *General standards of financial statement presentation*

CICA 1400 "General Standards of Financial Statement Presentation" was amended to include requirements to assess and disclose an entity's ability to continue as going concern.

The adoption of these new sections had no impact on the Company's consolidated financial statements.

##### 2008

##### *Capital*

Section 1535 "Capital Disclosures" establishes standards for disclosing information about an entity's capital and how it is managed. These standards require entity to disclose the following:

- ▶ Its objectives, policies and processes for managing capital;
- ▶ Whether during the year it complied with any externally imposed capital requirements to which it is subject;
- ▶ When the entity has not complied with such requirements, the consequences of such non-compliance.

##### *Financial instruments*

Section 3862 "Financial Instruments – Disclosures" modifies the disclosure requirements for financial instruments that were included in Section 3861 "Financial Instruments – Disclosure and Presentation". The new standards require entities to provide disclosures in their financial statements that enable users to evaluate:

- ▶ the significance of financial instruments for the entity's financial position and performance;
- ▶ the nature and extent of risks arising from financial instruments to which the entity is exposed during the year and at the balance sheet date, and how the entity manages those risks.

Section 3863 "Financial Instruments – Presentation" carries forward the presentation requirements of the old Section 3861 "Financial Instruments – Disclosure and Presentation", which remains unchanged.

With the exception of the disclosures required under the aforementioned sections, the adoption of these new standards had no material effect on the Company's consolidated financial statements.

### 3. NEW ACCOUNTING POLICIES (Cont'd)

#### B) Recently Issued

In January 2009, the AcSB released Section 1582 “Business Combinations”, Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-Controlling Interest”, which replace Section 1581 “Business Combinations” and Section 1600 “Consolidated Financial Statements”.

#### *Business combinations*

Section 1582 provides the Canadian equivalent to IFRS 3 “Business Combinations”. The new recommendations require measuring business acquisitions at the fair value of the acquired business, including the measurement at fair value of items such as non-controlling interest and contingent payment considerations. Also, the previously unrecognized deferred tax assets related to the acquired subsequent to the business combination are recognized in the consolidated statements of operations rather than as a reduction of goodwill. In addition, business acquisition related costs are expensed as incurred.

The adoption of Section 1582 could have a material effect on the accounting for business combinations that will occur subsequent to the adoption of this standard. The Company will adopt this standard on November 1, 2009.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS

The CICA plans to replace the Canadian GAAP with the International Financial Reporting Standards (IFRS) over a transition period to end in 2011. The Company is currently assessing the impact of the transition to IFRS on its financial statements.

### 5. RESTRUCTURING CHARGES

On December 13, 2006, the Company announced a shift in its business strategy, including the decision to discontinue supporting R&D activities related to improvements in its cell-based bladder cancer diagnostic test and a reduction in marketing initiatives for this product. This decision has resulted in a realignment of resources to support the new strategy and a reduction in the number of employees supporting certain research and development projects, including related marketing and administrative positions. The total restructuring charge was \$1,317,719 of which \$1,198,931 was paid as of October 31, 2009, and \$118,788 is still outstanding as follows:

	Opening balance of liabilities as of October 31, 2008 \$	Items paid during the year \$	Closing balance as of October 31, 2009 \$
Provision for vacated leased premises	363,151	244,363	118,788

## 6. TEMPORARY INVESTMENTS

	2009		2008	
	Amortized cost	Weighted average effective rate	Amortized cost	Weighted average effective rate
	\$	%	\$	%
Bonds	<b>8,918,860</b>	<b>3.31</b>	11,476,739	3.47

## 7. ACCOUNTS RECEIVABLE

	2009	2008
	\$	\$
Research and license agreement	<b>113,270</b>	110,770
Accounts receivable – Trade	<b>26,067</b>	193,049
Sales taxes	<b>44,811</b>	48,674
Other	<b>31,185</b>	—
	<b>235,333</b>	352,493

The accounts receivable denominated in US dollars amount to \$151,216 (US\$138,982) as at October 31, 2009, (\$257,064 [US\$227,934] as at October 31, 2008). The accounts receivable denominated in Euros amount to \$8,046 (5,050 Euros) as at October 31, 2009, (\$10,010 [6,320 Euros] as at October 31, 2008).

## 8. LONG TERM INVESTMENTS

	2009		2008	
	Amortized cost	Weighted average effective rate	Amortized cost	Weighted average effective rate
	\$	%	\$	%
Bonds	<b>823,912</b>	<b>4.60</b>	7,757,539	4.11

The long-term investments are maturing at various dates from November 2009 to November 2010.

## 9. PROPERTY, PLANT AND EQUIPMENT

	2009		2008	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
	\$	\$	\$	\$
Leasehold improvements	<b>1,246,710</b>	<b>1,200,872</b>	1,246,710	1,177,706
Office furniture and equipment	<b>420,127</b>	<b>350,488</b>	418,234	317,522
Laboratory equipment	<b>3,212,434</b>	<b>2,466,074</b>	3,146,872	2,088,831
Computer hardware and software	<b>777,798</b>	<b>639,759</b>	751,573	498,442
	<b>5,657,069</b>	<b>4,657,193</b>	5,563,389	4,082,501
Accumulated depreciation	<b>4,657,193</b>		4,082,501	
	<b>999,876</b>		1,480,888	

## 10. INTANGIBLES

	2009	2008
	\$	\$
Licenses and patents	12,008,245	11,968,993
Less: accumulated amortization	2,650,947	1,460,750
	<b>9,357,298</b>	<b>10,508,243</b>

Intangible assets consist of exclusive licenses acquired from third parties with respect to the use of certain intellectual properties and professional fees incurred to date for obtaining patents and securing exclusive licenses for products that are approved for sale. These costs are amortized on a straight-line basis over the life of the patents or over the term of the license agreements, which is 10 years.

## 11. CAPITAL STOCK

### Authorized

An unlimited number of shares of the following classes, without par value:

Common, voting and participating shares.

Preferred shares, issuable in series, non-voting, of which the rights, privileges, restrictions and conditions attached to each series will be determined by the directors upon the issuance of each series. They have a fixed, preferential and non-cumulative dividend of 6% per annum, and may be exchanged at the option of the holder for common shares on a one-for-one basis. DiagnoCure has the option to redeem the preferred shares or to require their conversion into common shares in certain circumstances.

### Common shares

	2009	2008
	\$	\$
<b>Issued and fully paid</b>		
42,957,475 common shares (42,794,475 as at October 31, 2008)	<b>92,015,103</b>	91,885,595

	2009		2008	
	Number of shares	Amount \$	Number of shares	Amount \$
Balance, beginning of year	42,794,475	91,885,595	41,718,463	89,609,479
Issuance of common shares on exercise of stock options	163,000	71,040	114,834	155,566
Issuance of common shares	—	—	961,178	2,007,150
Portion previously recognized to surplus as part of stock-based compensation	—	58,468	—	113,400
Balance, end of year	<b>42,957,475</b>	<b>92,015,103</b>	42,794,475	91,885,595

## 11. CAPITAL STOCK (Cont'd)

### Preferred shares

	2009	2008
	\$	\$
Issued and fully paid		
4,900,000 Series A Convertible Preferred Shares (— as at October 31, 2008)	<u>5,857,000</u>	—

	2009	
	Number of shares	Amount \$
Balance, beginning of year	—	—
Issuance of preferred shares	4,900,000	5,857,000
Balance, end of year	<u>4,900,000</u>	<u>5,857,000</u>

### A) Issuance of Shares

#### Fiscal 2009

##### *Common shares issue*

163,000 common shares were issued for a cash consideration of \$71,040 following the exercise of stock options.

##### *Preferred shares issue*

On April 29, 2009, DiagnoCure and Gen-Probe executed an amendment to their 2003 license agreement. On May 7, 2009, pursuant to the amendment, Gen-Probe acquired 4.9 million of newly issued DiagnoCure Series A Convertible Preferred Shares for a cash consideration of US\$5.0 million. The expenses related to this issuance amount to \$70,174.

#### Fiscal 2008

##### *Common shares issue*

The Company issued 467,477 common shares at a price of \$2.14 per share for a total value of \$1,000,000 and 493,701 common shares at a price of \$2.04 per share for a total value of \$1,007,150, to Targeted Diagnostics and Therapeutics, Inc. as per the license agreement signed in 2007. This issue of common shares and increase in licenses totaling \$2,007,150 did not involve any cash consideration and is not presented in the statement of cash flows.

114,834 common shares were issued for a cash consideration of \$155,566 following the exercise of stock options.

### B) Stock Options

The Company adopted a stock option plan for its directors, senior executives, employees and consultants under which a total of 7% of the Company's outstanding common shares were reserved for issue. No stock options are granted for a period exceeding ten years and the exercise price of each stock option cannot be below the average market price of the five days preceding the grant. The stock options generally vest over a three-year period following the date of the grant.

## 11. CAPITAL STOCK (Cont'd)

### B) Stock Options (Cont'd)

The Company's outstanding stock options as at October 31, 2009 and 2008 and the changes that occurred during the years then ended are as follows:

	2009		2008	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Options outstanding, beginning of year	3,361,226	2.45	3,122,417	2.68
Granted	554,000	0.81	644,400	1.93
	3,915,226		3,766,817	
Exercised	(163,000)	0.44	(114,834)	1.35
Cancelled or forfeited	(915,291)	2.32	(290,757)	4.20
Options outstanding, end of year	2,836,935	2.28	3,361,226	2.45
Options exercisable, end of year	1,460,490	2.75	2,091,160	2.39

Of the 2,836,935 options outstanding as at October 31, 2009, 875,000 options were issued outside of the plan.

The following table summarizes information relating to the stock options outstanding as at October 31, 2009:

Range of exercise prices	Options outstanding			Options exercisable	
	Number of options	Weighted average contractual life (years)	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
4.21 to 6.13	335,000	5.50	4.53	335,000	4.53
2.68 to 3.96	949,706	7.01	3.11	574,938	3.12
1.59 to 2.17	716,500	7.28	1.84	267,824	1.76
0.96 to 1.43	399,728	7.21	1.13	141,727	1.32
0.62	295,000	9.25	0.62	—	—
0.37 to 0.40	141,001	3.49	0.39	141,001	0.39
	2,836,935	6.98	2.28	1,460,490	2.75

During the three-month period ended January 31, 2009, the Company granted 296,000 (313,500 during the three-month period ended January 31, 2008) options to certain employees and directors. The weighted average fair value of stock options granted during this period amounted to \$0.62 (\$1.31 during the three-month period ended January 31, 2008) per stock option.

During the three-month period ended April 30, 2009, the Company did not grant options (300,000 during the three-month period ended April 30, 2008) to employees and directors. The weighted average fair value of stock options granted during the three-month period ended April 30, 2008 was \$1.34 per stock option.

During the three-month period ended July 31, 2009, the Company granted 7,000 (30,900 during the three-month period ended July 31, 2008) options to certain employees and directors. The weighted average fair value of stock options granted during this period amounted to \$0.62 (\$2.18 during the three-month period ended July 31, 2008) per stock option.

## 11. CAPITAL STOCK (Cont'd)

### B) Stock Options (Cont'd)

During the three-month period ended October 31, 2009, the Company granted 252,000 (none during the three-month period ended October 31, 2008) options to certain employees and directors. The weighted average fair value of stock options granted during the three-month period ended October 31, 2009 amounted to \$0.75 per stock option.

The fair value of each option granted was determined using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three-month periods							
	January 31		April 30		July 31		October 31	
	2009	2008	2009	2008	2009	2008	2009	2008
Risk-free interest rate	2.44%	3.93%	—	3.69%	3.05%	3.80%	3.08%	—
Expected life	8 years	8 years	—	8 years	8 years	8 years	8 years	—
Expected volatility factor	76%	70%	—	70%	76%	70%	76%	—
Expected dividend yield	—	—	—	—	—	—	—	—

### C) Contributed Surplus

	2009	2008
	\$	\$
Balance, beginning of year	7,069,693	6,063,454
Stock-based compensation expense	591,586	1,119,639
Stock options exercised	(58,468)	(113,400)
Balance, end of year	7,602,811	7,069,693

Stock-based compensation is amortized to expense on a straight-line basis over the vesting period, which is usually three years.

### D) Loss per Share

No adjustments were required to the net loss for purposes of calculating basic and diluted loss per share. There were also no adjustments to the weighted average number of shares outstanding for the purpose of calculating diluted loss per share, because to do so would be anti-dilutive.

## 12. CASH FLOWS

The composition of cash and cash equivalents is as follows:

	2009	2008
	\$	\$
Cash	1,782,797	896,427
Government of United States Treasury Bills, bearing interest at a rate of 2.00%	3,029,320	—
	4,812,117	896,427

## 13. INVESTMENT TAX CREDITS RECEIVABLE AND GOVERNMENT ASSISTANCE

The Company incurred research and development expenditures that are eligible for Quebec SR & ED investment tax credits. The credits, totaling \$420,021 (\$486,149 in 2008), were applied against research and development expenses.

### 13. INVESTMENT TAX CREDITS RECEIVABLE AND GOVERNMENT ASSISTANCE (Cont'd)

The amounts recorded as research and development tax credits receivable are related to amounts claimed and are subject to a review by the tax authorities. In case of differences between the amounts claimed by the Company and the amounts granted by the tax authorities, any adjustment will be recorded during the year in which they are determined.

In addition, the Company has investment tax credits which it has not recognized the benefit of that it may carry forward for federal tax purposes as follows:

Year of credit	Amount \$	Year of expiry
October 31, 1998	409,000	2018
October 31, 1999	216,000	2019
October 31, 2000	150,000	2020
October 31, 2001	226,000	2021
October 31, 2002	189,000	2022
October 31, 2003	183,000	2023
October 31, 2004	325,000	2024
October 31, 2005	540,000	2025
October 31, 2006	445,000	2026
October 31, 2007	351,000	2027
October 31, 2008	338,000	2028
October 31, 2009	184,000	2029
	3,556,000	

### 14. INCOME TAXES

The income tax expense reported differs from the amount of the tax expense computed by applying statutory income tax rates to the loss before taxes. The reasons for the differences and the related tax effects are as follows:

	2009 \$	2008 \$
Income tax provision at combined Canadian federal and provincial statutory rate	3,973,000	4,329,000
Increase (decrease) in taxes recoverable resulting from:		
Foreign income taxed at different rates	162,000	160,000
Non deductible expenses	(109,000)	(294,000)
Change in tax rates	(240,000)	(1,795,000)
Unrecognized tax benefits of operating losses and other available deductions	(3,786,000)	(2,309,637)
	—	90,363

The major components of future income taxes are as follows:

	2009 \$	2008 \$
<b>Future income tax assets</b>		
Net operating losses carried forward	12,739,000	9,696,000
Net capital losses carried forward	114,000	114,000
Research and development expenditures	3,354,000	3,300,000
Provision for vacated leased premises	32,000	119,000
Share issue costs	194,000	291,000
Tax value of capital assets in excess of carrying values	2,351,000	2,468,000
Total future income tax assets	18,784,000	15,988,000
Valuation allowance	(18,784,000)	(15,988,000)
<b>Net future income tax assets</b>	—	—
<b>Future income tax liabilities</b>		
Future foreign income taxes	1,014,929	1,014,929

## 14. INCOME TAXES (Cont'd)

The Company has the following non-capital tax losses, which are available to reduce future taxable income and expire as follows:

Year of loss	Canada		United States	Year of expiry
	Federal \$	Québec \$		
October 31, 2003	2,743,000	2,626,000	—	2010
October 31, 2005	2,000	2,000	—	2015
October 31, 2006	4,768,000	4,407,000	—	2026
October 31, 2007	12,662,000	12,395,000	—	2027
October 31, 2008	9,069,000	8,687,000	4,076,000	2028
October 31, 2009	7,027,000	6,608,000	5,235,000	2029
	36,271,000	34,725,000	9,311,000	

As at October 31, 2009, the Company has scientific research and experimental development expenses which have not been deducted for tax purposes and may be used to reduce the Company's taxable income in future years, with no set expiry date, amounted to approximately \$12,487,000 at the federal level and \$20,485,000 at the Québec level.

## 15. FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost. The classification of the financial instruments as well as their carrying values and fair values are shown in the table below:

	October 31, 2009					
	Held for trading \$	Held-to- maturity \$	Loans and receivables \$	Other financial liabilities \$	Carrying value total \$	Fair value total \$
<b>Financial assets</b>						
Cash and Cash equivalents	4,812,117	—	—	—	4,812,117	4,812,117
Temporary investments	—	8,918,860	—	—	8,918,860	8,985,988
Accounts receivable <sup>(1)</sup>	—	—	190,522	—	190,522	190,522
Long-term investments	—	823,912	—	—	823,912	835,616
	4,812,117	9,742,772	190,522	—	14,745,411	14,824,243
<b>Financial liabilities</b>						
Accounts payable <sup>(2)</sup>	—	—	—	1,897,497	1,897,497	1,897,497

## 15. FINANCIAL INSTRUMENTS (Cont'd)

	October 31, 2008					
	Held for trading	Held-to-maturity	Loans and receivables	Other financial liabilities	Carrying value total	Fair value total
	\$	\$	\$	\$	\$	\$
<b>Financial assets</b>						
Cash and Cash equivalents	896,427	—	—	—	896,427	896,427
Temporary investments	—	11,476,739	—	—	11,476,739	11,484,734
Accounts receivable <sup>(1)</sup>	—	—	268,552	—	268,552	268,552
Long-term investments	—	7,757,539	—	—	7,757,539	7,853,710
	896,427	19,234,278	268,552	—	20,399,257	20,503,423
<b>Financial liabilities</b>						
Accounts payable <sup>(2)</sup>	—	—	—	2,401,456	2,401,456	2,401,456

<sup>(1)</sup> Excluding investment tax credits, commodity and other taxes.

<sup>(2)</sup> Excluding other accruals.

As at October 31, 2009, cash and cash equivalents, temporary and long-term investments had been classified in the Level 2 fair value hierarchy (significant other observable inputs).

### Fair value

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

#### *Held for trading*

Cash and cash equivalents – The carrying amount is recorded at the fair value determined using quoted market prices.

#### *Held-to-maturity*

Temporary and long-term investments – After their initial fair value measurement, the carrying amount is measured at amortized cost using the effective interest rate method.

#### *Loans and receivables / Other financial liabilities*

Accounts receivables and accounts payable – The carrying amount is a reasonable approximation of fair value due to the short-term nature of the accounts.

#### *Risk arising from financial instruments*

The Company does not use financial derivatives.

#### **Foreign currency risk**

The Company operates internationally and a portion of its expenses are incurred in US dollars and Euros. A significant change in the currency exchange rate between the Canadian dollar relative to the US dollars or Euros could have a material effect on its consolidated results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

## 15. FINANCIAL INSTRUMENTS (Cont'd)

### Foreign currency risk (cont'd)

The Company maintains available for sale cash equivalents, accounts payable and accrued liabilities in US dollars and is therefore exposed to foreign exchange risk on these balances.

The significant balances in foreign currencies as at October 31 are as follow:

	2009 US dollars \$	2008 US dollars \$
Cash and cash equivalents	3,795,350	309,750
Accounts receivable	138,982	244,615
Accounts payable	(657,261)	(654,758)
<b>Net exposure</b>	<b>3,277,071</b>	<b>(100,393)</b>

Based on the aforementioned net exposure as at October 31, 2009 and 2008, and assuming that all other variable remain constant, a 5% rise or fall in the Canadian dollar against the US dollar would have resulted in (increase) decrease in the net loss as follows:

	2009 Canadian dollars		2008 Canadian dollars	
	Appreciates 5% \$	Depreciates 5% \$	Appreciates 5% \$	Depreciates 5% \$
Against US dollar				
Net loss	(163,854)	163,854	5,020	(5,020)

### Credit risk

Credit risk is the risk that an unexpected loss occurs if a counterparty to a financial instrument fails to meet its contractual obligations.

Investment tax credits receivable are due from the Québec government. All of the cash and cash equivalents are held with Canadian chartered banks. Temporary and long-term investments are held in bonds of municipalities, hospitals, CEGEPs and government bodies and therefore do not represent a concentration risk. These assets are convertible into a known amount of cash and subject to minimal risk of changes in value. The maximal credit risk exposure is limited to the carrying value of its cash, investments and accounts receivable.

As at October 31, 2009, one client represented 35% of the accounts receivable (in 2008 one client represented 77%). The total revenue in 2009 from this client represented \$941,353 (\$443,201 in 2008). All the revenue from this client comes from the Biotechnologies segment. The Company generates the majority from the revenue under research and license agreement in the Biotechnologies segment.

### Liquidity risk and market risk

The Company's investment policy is to invest its excess cash in high-grade investment bonds with varying terms to maturity, selected with regard to the expected timing of expenditures for continuing operations.

The Company's investments are comprised of government guaranteed bonds subject to minimal fluctuations in value.

## **16. MANAGEMENT OF CAPITAL**

The Company's objectives when managing capital is to safeguard its ability to continue as a going concern, to provide returns for shareholders and to minimize its cost of capital.

In the management of capital, the Company includes shareholders' equity which amounts to \$23,224,245 (\$29,639,848 in 2008) in the definition of capital.

The Company's primary objective with respect to its capital management is to ensure that it has sufficient cash resources to fund its research and development and marketing activities and to maintain its ongoing operations. To secure additional capital necessary to pursue these plans, the Company may attempt to raise additional funds through the issuance of debt or equity, through merger and acquisitions transactions, by securing additional partnerships or research collaboration or by disposing of assets.

The Company is satisfied that it has adequate cash resources to carry out its research and development activities and its ongoing operations and will monitor its cash level as sales and marketing activities accelerate.

## **17. COMMITMENTS AND GUARANTEES**

As at October 31, 2009, the Company has obligations under leases maturing in 2011 and 2015. The minimum annual payments in relation with these leases for the next five years are as follows: 2010 – \$563,313; 2011 – \$358,189; 2012 – \$251,548; 2013 – \$251,548 and 2014 – 251,548 \$.

During the year ended October 31, 2007, the Company entered into license agreements with third parties regarding certain intellectual property rights. Those agreements were for an initial term of 10 years. The Company agreed to pay royalties on all products sold derived from the underlying technologies and milestone payments after achievement of the respective milestones, if applicable. The royalties that the Company might have to pay represent 5% to 10% of net sales and 20% of sublicense revenues. The total of the milestone payments that may have to be paid by the Company over the next years is \$2,125,000.

The Company periodically enters into research agreements or strategic alliances with third parties that include indemnification provisions that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is not limited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the intellectual property indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in these consolidated financial statements with respect to these indemnification obligations.

## 18. SEGMENTED INFORMATION

Information pertaining to segmented earnings for the years ended October 31, 2009 and October 31, 2008 is as follows:

	Consolidated amounts		Biotechnologies		Laboratory services	
	2009	2008	2009	2008	2009	2008
	\$	\$	\$	\$	\$	\$
Revenue from external sales	<b>1,112,529</b>	786,951	<b>1,070,818</b>	786,951	<b>41,711</b>	—
Interest revenues	<b>503,138</b>	1,208,959	<b>500,465</b>	1,208,959	<b>2,673</b>	—
Loss before the following items	<b>5,082,162</b>	4,404,893	<b>2,363,058</b>	2,021,818	<b>2,719,104</b>	2,383,075
Stock-based compensation	<b>591,586</b>	1,119,639	<b>591,586</b>	1,119,639	—	—
Depreciation and amortization	<b>1,764,889</b>	1,629,360	<b>1,596,252</b>	1,562,598	<b>168,637</b>	66,762
Segmented loss	<b>7,438,637</b>	7,153,892	<b>4,550,896</b>	4,704,055	<b>2,887,741</b>	2,449,837
Net R&D expenses	<b>5,400,682</b>	6,660,778	<b>3,062,069</b>	5,040,211	<b>2,338,613</b>	1,620,567
Financial expenses	<b>25,736</b>	19,308	<b>10,835</b>	13,587	<b>14,901</b>	5,721
Net loss	<b>12,865,055</b>	13,833,978	<b>7,623,800</b>	9,757,853	<b>5,241,255</b>	4,076,125

The business segment Laboratory services reflects the Company's U.S. activities in its Previstage™ GCC colorectal cancer staging test initiative. The Laboratory services activities are performed by the subsidiary DiagnoCure U.S. GP. The accounting policies of the reportable segments are the same as those described in note 2 "Significant accounting policies". Assets relating to the Biotechnologies segment represent 97% of the consolidated assets and are located in Canada.

For the Biotechnologies segment, one American client represented 85% (56% in 2008) of the revenues from external sales. The total revenue in 2009 from this client represented \$941,353 (\$443,201 in 2008). The Company generates the majority of its revenue from the revenue under research and license agreement in the Biotechnologies segment.

In 2009, the total external sales are attributable to the United States. In 2008, \$579,710 was attributable to the United States, \$59,293 to Canada and \$147,948 to Europe. The Company determines the revenues by country based on where the product or service is delivered.

## 19. COMPARATIVE FIGURES

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

## CORPORATE INFORMATION

### Board of Directors

Michel E. Côté <sup>2</sup>  
Corporate Director

Yves Fradet, M.D., F.R.C.S. (c)  
Chairman of the Board,  
Senior Vice President,  
Chief Medical Officer, DiagnoCure, Inc.

Paul Gobeil, FCA <sup>1</sup>  
Lead Director, DiagnoCure, Inc.  
Vice Chairman of the Board, Metro, Inc.

Alain G. Michel <sup>1</sup>  
Chairman of the Board,  
Cari-All Group, Inc.

Louise Proulx, Ph.D. <sup>1</sup>  
Vice President, Product Development,  
ViroChem Pharma, Inc.

John C. Schafer  
President and Chief Executive Officer,  
DiagnoCure, Inc.

Mario Thomas, Ph.D. <sup>2</sup>  
Managing Director, Center for  
Commercialization of Research,  
Ontario Centers of Excellence

Vincent R. Zurawski, Jr., Ph.D. <sup>2</sup>  
President and CEO,  
Varinel, Inc.

<sup>1</sup> Audit and Risk Management Committee  
<sup>2</sup> Corporate Governance, Human Resources  
and Nominating Committee

### Management

John C. Schafer  
President and Chief Executive Officer

Jean-François Bureau, CFA  
Senior Vice President  
and Chief Financial Officer

Yves Fradet, M.D., F.R.C.S. (c)  
Senior Vice President  
and Chief Medical Officer

Paule De Blois, MBA  
Vice President, Corporate Affairs

Michel Houde, Ph.D.  
Vice President,  
Research and Development

Phillip Wells  
Vice President,  
Marketing and National Sales

### General Information

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### Stock Exchange Listing

The Company's common shares  
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under the symbol CUR.



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