



**Victhom** Human Bionics

**Consolidated Financial Statements  
December 31, 2008 and 2007**

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# Raymond Chabot Grant Thornton

## Auditors' Report

To the Shareholders of  
Victhom Human Bionics Inc.

**Raymond Chabot Grant Thornton LLP**

Suite 200  
140 Grande Allée East  
Québec, Québec G1R 5P7

Telephone: 418-647-3151  
Fax: 418-647-5939  
www.rcgt.com

We have audited the consolidated balance sheets of Victhom Human Bionics Inc. as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive loss, contributed surplus, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

/S/ Raymond Chabot Grant Thornton, LLP<sup>1</sup>

Québec, February 20, 2009 (April 29, 2009 for note 18)

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<sup>1</sup> Chartered accountant auditor permit no. 9640



**Victhom** Human Bionics

**Consolidated Statements of Operations and Comprehensive Loss**

Years ended on December 31

	<u>2008</u>	<u>2007</u>
	\$	\$
<b>Revenues</b>	<u>2,286,468</u>	<u>2,271,600</u>
<b>Expenses</b>		
Research and development	10,100,239	8,513,547
Tax credits and grants	(1,098,782)	(1,031,191)
General and administrative	2,429,071	2,552,777
Financial	5,791,885	(585,615)
	<u>17,222,413</u>	<u>9,449,518</u>
Write-down of intangible assets (Note 8)	1,344,444	-
	<u>18,566,857</u>	<u>9,449,518</u>
<b>Net loss and comprehensive loss</b>	<u>16,280,389</u>	<u>7,177,918</u>
Weighted average number of common shares outstanding	<u>98,412,072</u>	<u>82,046,201</u>
Basic and diluted net loss per share	<u>0.165</u>	<u>0.087</u>

The accompanying notes are an integral part of the consolidated financial statements and Note 14 provides additional information on the consolidated statements of operations.



**Victhom** Human Bionics

**Consolidated Statement of Contributed Surplus and Deficit**

Years ended on December 31

	<u>2008</u>	<u>2007</u>
	\$	\$
<b>CONTRIBUTED SURPLUS</b>		
Balance, beginning of year	9,884,497	7,535,941
Warrants issued in public offering	-	2,024,866
Stock-based compensation related to:		
Stock options vested (Note 12)	173,961	325,437
Stock options exercised	-	(1,747)
Balance, end of year	<u>10,058,458</u>	<u>9,884,497</u>
<b>DEFICIT</b>		
Balance, as previously reported	(41,491,722)	(31,730,043)
Restatement related to the correction of an error (Note 10)	<u>3,168,926</u>	<u>585,165</u>
Balance, as restated	(38,322,796)	(31,144,878)
Net loss	<u>(16,280,389)</u>	<u>(7,177,918)</u>
Balance, end of year	<u>(54,603,185)</u>	<u>(38,322,796)</u>

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



**Victhom** Human Bionics  
**Consolidated Statements of Cash Flows**  
 Years ended on December 31

	2008	2007
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss	(16,280,389)	(7,177,918)
Non-cash items:		
Stock-based compensation (Note 12)	173,961	325,437
Interest on convertible debentures	2,709,313	2,482,774
Exchange rate variation on convertible debentures (Note 10)	3,288,836	(2,583,761)
Amortization of property, plant and equipment	730,624	694,266
Write-down of intangible assets	1,344,444	-
Amortization of intangible assets	62,767	72,600
Changes in working capital items	(683,282)	1,971,453
Cash flows from operating activities	<u>(8,653,726)</u>	<u>(4,215,149)</u>
<b>INVESTING ACTIVITIES</b>		
Short-term investments	(3,000,000)	-
Property, plant and equipment	(284,909)	(170,846)
Intangible assets	(150,563)	(375,625)
Cash flows from investing activities	<u>(3,435,472)</u>	<u>(546,471)</u>
<b>FINANCING ACTIVITIES</b>		
Demand loan	765,000	(820,000)
Repayment of long-term debt	-	(30,978)
Issue of shares and warrants, net of costs	-	11,556,121
Cash flows from financing activities	<u>765,000</u>	<u>10,705,143</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(11,324,198)</b>	<b>5,943,523</b>
Cash and cash equivalents, beginning of year	<u>12,442,377</u>	<u>6,498,854</u>
Cash and cash equivalents, end of year	<u><u>1,118,179</u></u>	<u><u>12,442,377</u></u>
Interest paid during the year	24,456	15,048
Non-monetary financing activities are detailed as follows:		
Issue of shares related to:		
Exercise of stock options	-	1,747
Payment of interest due on convertible debentures	1,306,194	1,302,624
Issue of warrants	-	2,024,866
Cash and cash equivalents are detailed as follows:		
Cash in National Bank of Canada	221,495	675,802
Money market securities, interest of 2.97% annually, maturing January 28, 2009	896,684	-
Banker's acceptance, interest of 4.65% annually, matured January 3, 2008	-	2,748,954
Banker's acceptance, interest of 4.54% annually, matured January 23, 2008	-	1,096,864
Money market securities, interest of 3.98% annually, matured April 1, 2008	-	7,920,757
	<u><u>1,118,179</u></u>	<u><u>12,442,377</u></u>

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



**Victhom** Human Bionics  
**Consolidated Balance Sheets**  
 As of December 31

	2008	2007
	\$	\$
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	1,118,179	12,442,377
Short-term investments (Note 5)	3,001,033	-
Accounts receivable (Note 6)	2,347,209	1,293,916
Prepaid expenses	428,850	174,980
	<u>6,895,271</u>	<u>13,911,273</u>
Property, plant and equipment (Note 7)	1,955,291	2,401,006
Intangible assets (Note 8)	8,444,457	9,701,105
	<u>17,295,019</u>	<u>26,013,384</u>
<b>LIABILITIES</b>		
Current liabilities		
Demand loan (Note 9)	765,000	-
Accounts payable and accrued liabilities	2,110,708	1,307,162
Deferred revenues	16,398	195,030
	<u>2,892,106</u>	<u>1,502,192</u>
Liability component of convertible debentures (Note 10)	16,413,460	11,721,505
	<u>19,305,566</u>	<u>13,223,697</u>
<b>SHAREHOLDERS' EQUITY (Deficiency)</b>		
Equity component of convertible debentures (Note 10)	1,551,780	1,551,780
Capital stock (Note 11)	40,982,400	39,676,206
Contributed surplus	10,058,458	9,884,497
Deficit	(54,603,185)	(38,322,796)
	<u>(2,010,547)</u>	<u>12,789,687</u>
	<u>17,295,019</u>	<u>26,013,384</u>

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

On behalf of the Board,

/s/ Daniel Johnson  
 Chairman

/s/ Nitin Kaushal  
 Director



## **Notes to Consolidated Financial Statements**

as of December 31, 2008 and 2007

### **1 - GOVERNING STATUTES AND NATURE OF OPERATIONS**

The Company, incorporated under the Canada Business Corporations Act, is a medical device company that specializes in the development and commercialization of bionic devices aimed at improving the quality of life of individuals suffering from certain physical dysfunctions. The Company has two divisions. Victhom's Neurobionix division develops implantable closed-loop system ("CLS") devices for the measurement (sensing) and the stimulation of peripheral nerves for the restoration of physiological functions, involving neurosensor implants and neurostimulators. Victhom's Biotronix division develops biomechatronic product candidates to support or replace peripheral limbs in what is known as the orthotics and prosthetics "O&P" market.

### **2 - GOING CONCERN**

In past years, the Company has incurred operating losses and had a working capital deficiency. Furthermore, the Company expects to incur additional expenditures to complete the development and marketing of its products. Its ability to generate future revenues and cash flows from its operating activities depends on several factors, including its ability to secure additional financing and have its products accepted by the regulatory agencies and the market. The Company will require additional financing to fund its continuing operations and development, and conduct clinical trials. Accordingly, there is significant doubt about the Company's ability to continue as a going concern.

These financial statements have been prepared in accordance with Canadian GAAP using the going-concern assumption, which assumes that the Company will be able to realize assets and discharge liabilities in the normal course of operations. The Company believes that following the transaction described in Note 18, which is subject to Company's debenture holders and shareholders approval, it will have sufficient liquidity to fund its continuing operations. Therefore, these financial statements do not reflect the adjustment that might be necessary to the carrying-amount of reported assets, liabilities, revenues and expenses, and the balance sheet classification used if the Company were unable to continue operation in accordance with the going-concern assumption.

### **3 - ACCOUNTING POLICIES**

#### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary companies. All significant intercompany balances and transactions have been eliminated on consolidation.

#### **Accounting estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results may differ from these estimates.

#### **Adoption of new accounting policies**

Effective:

On January 1, 2008, in accordance with the applicable transitional provisions, the Company adopted new accounting standards which only address disclosures and have no impact on the Company's financial results. The new accounting standards are:

In June 2007, the Canadian Institute of Chartered Accountants modified Section 1400, "General Standards of Financial Statement Presentation", in order to require that management make an assessment of the Company's ability to continue as a going concern over a period which is at least, but is not limited to, twelve months from the balance sheet date.



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 3 - ACCOUNTING POLICIES (Continued)

In December 2006, the Canadian Institute of Chartered Accountants published a new accounting standard, namely Section 1535, "Capital Disclosures". The new section establishes standards for disclosing information about an entity's capital and how it is managed.

In December 2006, the CICA published new Sections 3862, "Financial Instruments - Disclosure and Presentation" and 3863, "Financial Instruments - Presentation", which deal with the presentation and disclosure of financial instruments and non-financial derivatives.

Future accounting standards:

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

#### Cash and cash equivalents

The Company's policy is to present short-term investments with a term of three months or less from the acquisition date with cash and cash equivalents.

#### Property, plant and equipment

Property, plant and equipment are recorded at cost and are amortized over their estimated useful life according to the diminishing balance method and the following annual rates:

	Rates
Computer equipment	30%
Furniture and equipment	20%

The leasehold improvements are amortized over the term of each lease agreement using the straight-line basis.

#### Intangible assets

Patents are recorded at cost and are amortized on a straight-line basis over ten years beginning the year in which the developed products are marketed.

The acquired technology is recorded at the acquisition cost. The technology will be amortized on a straight-line basis over ten years beginning the year in which the developed products are marketed.

#### Long-term asset depreciation

Depreciable property, plant and equipment and intangible assets are tested for impairment whenever events or changes in circumstances indicate that their carrying-amount may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying-amount. In such case, the impairment to be recognized is measured by the amount by which the carrying-amount of the asset exceeds the fair value.



## Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 3 - ACCOUNTING POLICIES (Continued)

#### Share issuance costs

The financing costs related to the issuance of common shares are recorded against the proceeds amount of the common shares issued.

#### Financial assets and liabilities

On initial recognition, all financial assets and liabilities are measured and recognized at their fair value, except for financial assets and liabilities resulting from certain related party transactions. Transaction costs from held-for-trading financial assets and liabilities are recognized in earnings and presented under financial expenses. Transaction costs from available-for-sale financial assets, held-to-maturity investments, loans and receivables increase the carrying-amount of the related financial assets. Transaction costs from other financial liabilities reduce the carrying-amount of the related financial liabilities. Regular-way purchases or disposals of financial assets are recognized at the transaction date.

Subsequently, financial assets and liabilities are measured and recognized as follows:

Held-for-trading financial assets and liabilities are measured at their fair value and changes in fair value are recognized in earnings. Changes in fair value that are recognized in earnings include interest and dividend income, exchange gains or losses, and realized and unrealized gains or losses, and are presented under financial expenses. The Company designates cash equivalents and short-term investments as held-for-trading because it considers that the financial information generated by this classification is more relevant for decision-making and provides better means for evaluating the Company's performance.

Available-for-sale financial assets, except for share investments in private companies, are measured at their fair value. Related unrealized gains and losses are recognized in other comprehensive income until these gains or losses are realized or a decline in value of the financial assets is other than temporary. For available-for-sale financial assets in foreign currency, exchange gains and losses are included in the unrealized gains or losses recognized in other comprehensive income.

Share investments in private companies are measured at cost.

When an investment is sold or sustains an impairment loss, the gain or loss accumulated in comprehensive income is then reclassified in the earnings under financial expenses.

Held-to-maturity investments, loans, receivables and other financial liabilities are measured at amortized cost using the effective interest method (including any impairment in the case of financial assets). Interest calculated using the effective interest method is presented under financial expenses. Trade accounts and other receivables are classified as loans and receivables. The accounts payable and accrued liabilities as well as the demand loan and the convertible debentures are classified as other financial liabilities.

#### Revenue recognition

By virtue of commercial license agreements, the Company must attain development objectives for its products and services based on a predetermined timetable to the benefit of the third party. Revenues are recognized in the statement of operations when they are earned. The agreement does not contemplate any terms of repayment in the event that the product is not marketed.

The revenues from any other research and development agreements are recognized, based on the contract signed by the parties, when the services and/or the products are delivered and accepted by the client.

Investment transactions are recorded on the transaction date and resulting revenues are recognized using the accrual basis. Interest income is accrued based on the number of days the investment is held during the period.



## Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 3 - ACCOUNTING POLICIES (Continued)

#### Foreign currency translation

Monetary assets and liabilities in foreign currency of Canadian corporations and integrated foreign operations are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at the exchange rates in effect at transaction dates. Revenues and expenses in foreign currency are translated at the average rate in effect during the year, with the exception of amortization, which is translated at the historical rate. Gains and losses are included in the results of the periods.

#### Research and development costs and investment tax credits

Research costs are expensed as they are incurred. Development costs are deferred when they meet the generally accepted criteria to the extent that their recovery can reasonably be regarded as assured.

Research and development tax credits are applied against the related costs in the year during which they are incurred. Investment tax credits for property, plant and equipment are presented as deferred credits and amortized to income on the same basis as the related amortizable property, plant and equipment are amortized. The investment tax credits must be examined and approved by the tax authorities and the amounts granted might differ from the amounts recorded.

#### Stock option plan

The Company provides a stock option plan, which is described in Note 12. A stock-based compensation expense is recognized with respect to this plan for stock options issued on or after January 10, 2003. Any consideration paid when exercising stock options and any contributed surplus related to these options are credited to capital stock.

#### Earnings per share

Basic earnings per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options and warrants. The "if-converted" method is used to determine the dilutive effect of convertible debentures.

The convertible debentures, the warrants and the stock options were not included in the computations of diluted earnings per share for the years ended on December 31, 2008 and 2007 because the Company reported losses and the inclusion of the securities would be anti-dilutive.

#### Income taxes

The Company uses the tax liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of the assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse. The Company records a valuation allowance for future income tax asset if, based on available information, it is more likely than not that some or all of the future income tax asset will not be realized.



**Victhom** Human Bionics

**Notes to Consolidated Financial Statements**

as of December 31, 2008 and 2007

**4 - INCOME TAXES**

The Company's effective income tax rate differs from the combined federal and provincial income tax rate in Canada. This difference is due to the following items:

	<u>2008</u>	<u>2007</u>
	\$	\$
Net loss	<u>(16,280,389)</u>	<u>(7,177,918)</u>
Income taxes calculated using the combined federal and provincial income tax rate in Canada of 30.90% (32.02% in 2007)	<b>(5,031,000)</b>	(2,298,000)
Increase (decrease) in income taxes resulting from the following:		
Unrecognized future income tax assets	<b>3,301,000</b>	2,699,000
Non-capital losses expired	<b>123,000</b>	-
Stock-based compensation	<b>54,000</b>	104,000
Interest on convertible debentures	<b>569,000</b>	496,000
Exchange rate variation on convertible debentures	<b>1,016,000</b>	(827,000)
Variation due to income tax rate adjustment	<b>439,000</b>	263,000
Research and development tax credit as per financial statements	<b>(340,000)</b>	(330,000)
Amortization of financing expenses	<b>(109,000)</b>	(161,000)
Non-deductible expenses and other items	<b>(22,000)</b>	54,000
Income taxes	<u>-</u>	<u>-</u>

The future income tax assets and liabilities result from the differences between the carrying amount and the tax basis of the following:

	<u>2008</u>	<u>2007</u>
	\$	\$
Future income tax assets		
Non-capital losses	<b>6,617,000</b>	5,067,000
Research and development expenses	<b>9,762,000</b>	8,262,000
	<u><b>16,379,000</b></u>	<u>13,329,000</u>
Future income tax liabilities		
Property, plant and equipment	<b>404,000</b>	446,000
Other assets	<b>124,000</b>	333,000
	<u><b>528,000</b></u>	<u>779,000</u>
	<u><b>15,851,000</b></u>	<u>12,550,000</u>
Valuation allowance	<b>(15,851,000)</b>	(12,550,000)
Net future income taxes	<u>-</u>	<u>-</u>



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 4 - INCOME TAXES (Continued)

The future income tax asset resulting from loss carry-forwards is not recorded in the financial statements. These losses and deductible temporary differences, which are available to reduce income taxes in future years, are as follows:

	Federal \$	Provincial \$
Amount of losses for tax purposes carried forward:		
2009	1,185,000	1,184,000
2010	1,383,000	1,086,000
2014	4,480,000	3,554,000
2015	1,940,000	2,076,000
2026	3,550,000	3,547,000
2027	5,898,000	4,058,000
2028	2,725,000	6,344,000
	<u>21,161,000</u>	<u>21,849,000</u>
Eligible research and development expenses to be deferred over an undetermined period	30,347,000	35,857,000
Amount of temporary variances to be deferred over an undetermined period	<u>1,710,000</u>	<u>1,710,000</u>
	<u>53,218,000</u>	<u>59,416,000</u>

In addition, the Company has investment tax credits amounting to approximately \$104,000, which are available until 2012, \$728,000 until 2013, \$952,000 until 2014, \$1,095,000 until 2015, \$1,258,000 until 2026, \$1,150,000 until 2027 and \$1,502,000 until 2028.

#### 5 - SHORT-TERM INVESTMENTS

	2008 \$	2007 \$
Commercial paper, bearing interest of 1.58% annually, maturing in June 2009	<u>3,001,033</u>	<u>-</u>

#### 6 - ACCOUNTS RECEIVABLE

	2008 \$	2007 \$
Investment tax credits receivable (1)	2,301,982	1,076,780
Sales taxes receivable	45,227	105,717
Trade accounts receivable	-	61,292
Others	-	50,127
	<u>2,347,209</u>	<u>1,293,916</u>

(1) In January 2009, the Company received \$1,034,104 for the 2007 investment tax credits receivable.



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 7 - PROPERTY, PLANT AND EQUIPMENT

	2008		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Computer equipment	1,674,547	1,155,877	518,670
Furniture and equipment	2,235,790	1,296,902	938,888
Leasehold improvements	1,491,798	994,065	497,733
	<u>5,402,135</u>	<u>3,446,844</u>	<u>1,955,291</u>
	2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Computer equipment	1,475,064	980,321	494,743
Furniture and equipment	2,150,364	1,073,657	1,076,707
Leasehold improvements	1,491,798	662,242	829,556
	<u>5,117,226</u>	<u>2,716,220</u>	<u>2,401,006</u>

#### 8 - INTANGIBLE ASSETS

	2008		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Patents	1,430,203	135,367	1,294,836
Acquired technology	7,149,621	-	7,149,621
	<u>8,579,824</u>	<u>135,367</u>	<u>8,444,457</u>
	2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Patents	1,370,299	72,600	1,297,699
Commercial license agreements	1,253,785	-	1,253,785
Acquired technology	7,149,621	-	7,149,621
	<u>9,773,705</u>	<u>72,600</u>	<u>9,701,105</u>

During 2008, the Company acquired \$143,010 (\$338,737 in 2007) in patents and has taken a write-down of \$83,106.

During the second quarter of 2008, management decided not to pursue projects under development related to commercial license agreements. Consequently, management has recorded a write-down of \$1,261,338 representing the whole capitalized value of commercial license agreements. This intangible asset relates to non-core projects in the Neurobionix division and the write-down is recognized against the research and development expenses.



## Victhom Human Bionics

Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 9 - CREDIT FACILITIES

During the third quarter of 2008, the Company obtained credit facilities totaling \$1,615,000 with a Canadian bank. The credit facilities are composed of: i) a demand loan for \$765,000, secured by 2007 investment tax credits receivable and ii) a demand loan for \$850,000, secured by 2008 investment tax credits receivable. The credit facilities are secured by a first call of \$1,665,000 on the universality of the Company's property with the exception of intellectual properties, bearing interest at prime rate plus 1.5% (5.0%), maturing with the receipt of the related investment tax credits receivable. In January 2009, the demand loan of \$765,000 was reimbursed with the receipt of the 2007 investment tax credits receivable.

Pursuant to the terms and conditions of the credit facilities, the Company is subject to certain debt covenants with regards to maintaining financial ratios. As of December 31, 2008, all debt covenants are respected. In February 2009, the credit facilities and the related guarantee were canceled following management's request.

### 10 - CONVERTIBLE DEBENTURES

The following table illustrates variations in the years:

	Liability component	Equity component
	\$	\$
Balance as of December 31, 2006 (a)	14,866,103	1,551,780
Presentation of deferred financing costs against the convertible debentures	(1,027,528)	-
Restatement in prior period related to Section 3855, "Financial Instruments"	(128,294)	-
Restatement related to the correction of an error	(585,165)	-
Imputed interest	2,482,774	-
Payment of interest	(1,302,624)	-
Exchange rate gain	(2,583,761)	-
Balance as of December 31, 2007	<u>11,721,505</u>	<u>1,551,780</u>
Imputed interest	2,709,313	-
Payment of interest	(1,306,194)	-
Exchange rate loss	3,288,836	-
<b>Balance as of December 31, 2008</b>	<b><u>16,413,460</u></b>	<b><u>1,551,780</u></b>

(a) Debentures issued having a par value of \$18,354,000, unsecured, bearing interest at the rate of 7% (effective rate of 17.12%), maturing on March 22, 2010. The liability and the equity components initially represented \$15,084,379. The remaining amount of \$3,269,621 is the fair value of the warrants granted, recorded as contributed surplus. As part of this financing, the Company paid \$1,590,411 in financing costs which are recorded as reduction of the liability component. The debentures are convertible into common shares of the Company at the option of the holders, in whole or in part at any time and from time to time. The conversion price in effect on any conversion date shall be equal to \$1.35.

All repayments of the principal amount shall be made in U.S. dollars at a fixed exchange rate of CAN\$ 1.2104 for each US\$ 1.00, representing US\$ 15,163,582. As of December 31, 2008, the principal amount of the convertible debentures converted into Canadian dollars represented \$18,469,243.

The liability component of the convertible debentures is the discounted value, at the date of issue, of the cash payments of interest and principal due under the terms of the convertible debentures, discounted at the rate of interest that would apply to a debt security without a conversion option, with similar maturity and risk. The equity component represents the value attributed to the difference between the amount issued and the liability component.



## Victhom Human Bionics

Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 10 - CONVERTIBLE DEBENTURES (Continued)

#### Correction of an error in prior financial statements

During the third quarter of 2008, the Company discovered an accounting discrepancy in its previously reported consolidated financial statements for fiscal years 2005 to 2007. The convertible debentures have a par value of CAN\$ 18,354,000, the biannual interests are payable in Canadian dollars, but all repayments of the principal amount shall be in U.S. dollars at a fixed exchange rate of CAN\$ 1.2104 for each US\$ 1.00. Therefore, the monetary liability in foreign currency should have been converted, since the beginning, at the closing exchange rate of the periods. This restatement had no cash impact. The Company decided to restate its 2007 financial statements as indicated below:

	December 31, 2007
<u>Balance sheets</u>	\$
Liability component of convertible debentures	(3,168,926)
Deficit	3,168,926
<u>Statement of operations</u>	
Financial expenses	(2,583,761)
Net loss	(2,583,761)
Basic and diluted net loss per share	(0.032)
<u>Statement of deficit</u>	
Balance, as previously reported	585,165

In 2008, the US/CAN exchange rate variation generated a non-cash loss of \$3,288,836 on the liability component of the convertible debentures. As of December 31, 2008, the cumulative exchange rate loss on the liability component of the convertible debentures was \$119,910.

### 11 - CAPITAL STOCK

#### Authorized

Unlimited number of common shares without par value, voting and participating.

#### Issued and fully paid

The following table indicates changes in the Company's capital stock over the years:

	Number of shares	Amount \$
Balance as of December 31, 2006	52,592,440	28,840,579
Shares issued related to public offering, less expenses of \$834,517	35,323,156	9,503,724
Shares issued related to interest due on convertible debentures	7,810,218	1,302,624
Stock options exercised	166,667	29,279
Balance as of December 31, 2007	<u>95,892,481</u>	<u>39,676,206</u>
Shares issued related to interest due on convertible debentures	<u>27,196,442</u>	<u>1,306,194</u>
<b>Balance as of December 31, 2008</b>	<b><u>123,088,923</u></b>	<b><u>40,982,400</u></b>



## Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 11 - CAPITAL STOCK (Continued)

During the first quarter of 2007, the Company completed a share and warrant financing with various investors. The Company issued 35,323,156 units at \$0.35 each as follows: each unit consists of one common share and half warrant. Each full warrant grants the right to subscribe to a common share for a price of \$0.45 for three years. The fair value of the warrants using the proportional allocation method, has been established to \$1,870,888 or \$0.106 per warrant. The Company issued 1,233,675 warrants bearing the same characteristics as fees for this financing for a fair value of \$153,978. No shares were included in this payment. In total, the fair value of the warrants issued in the financing was \$2,024,866.

During 2007, expenses related to shares issued including warrants amounted to \$988,495. The fair value of the warrants is accounted for as contributed surplus.

#### Warrants

As part of its financing operations, the Company issued warrants to investors entitling them with the right to purchase shares at a predetermined price. Each warrant issued can be used to purchase one common share of the Company.

At the time of issue, the fair value of the warrants issued, as part of the financing, is recognized as a decrease in capital stock upon issuance of shares or is recognized as a decrease of the debt. The consideration is recognized as contributed surplus in the balance sheet.

No warrants were issued during the year 2008. In 2007, the fair value of each warrant granted was estimated at the grant date using the Black-Scholes option pricing model, based on the following weighted average assumptions: expected volatility of 60%, risk-free interest rate of 3.91%, no expected dividends and expected life of 3 years. The weighted average fair value of the warrants granted in 2007 is \$0.13.

Outstanding warrants at the end of the years as well as the changes during the years are summarized in the table below:

	Number	Weighted average exercise price \$
Outstanding, as of December 31, 2006	7,613,511	1.58
Granted	18,895,253	0.45
Expired	(543,822)	1.35
Outstanding, as of December 31, 2007	<u>25,964,942</u>	<u>0.76</u>
<b>Outstanding, as of December 31, 2008</b>	<b><u>25,964,942</u></b>	<b><u>0.76</u></b>



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 11 - CAPITAL STOCK (Continued)

As of December 31, 2008, the following warrants were outstanding:

Range of exercise prices	Number of outstanding warrants	Weighted average remaining contractual life (in years)	Weighted average exercise price \$
\$0.45 to \$0.61	18,895,253	1.21	0.45
\$1.48 to \$1.60	7,069,689	1.25	1.60
<u>\$0.45 to \$1.60</u>	<u>25,964,942</u>	<u>1.22</u>	<u>0.76</u>

#### 12 - STOCK-BASED COMPENSATION

The Company has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Company. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date and the number of options to be granted. The exercise price of stock options is the market value of the Company's common shares at the market close on the trading day immediately preceding the date they are granted.

In 2008, the fair value of the stock options granted is estimated at the grant date using the Black-Scholes option pricing model, based on the following weighted average assumptions: expected volatility of 60% (same in 2007), risk-free interest rate of 3.71% (4.23% in 2007), no expected dividends and expected life of 6 years (same in 2007). The weighted average fair value of the stock options granted during 2008 is \$0.07 (\$0.13 in 2007).

The Company's stock option plan at the end of the years as well as the changes during the years are summarized in the table below:

	Number	Weighted average exercise price \$
Outstanding, as of December 31, 2006	4,575,729	0.98
Granted	4,075,000	0.22
Exercised	(166,667)	0.17
Forfeited	<u>(2,176,062)</u>	<u>0.97</u>
Outstanding, as of December 31, 2007	<u>6,308,000</u>	<u>0.51</u>
Granted	2,065,000	0.12
Forfeited	<u>(1,500,000)</u>	<u>0.46</u>
<b>Outstanding, as of December 31, 2008</b>	<b><u>6,873,000</u></b>	<b><u>0.40</u></b>
Exercisable, as of December 31, 2008	(3,520,884 at \$0.72 in 2007)	<u>0.55</u>

In 2008, the Company recorded \$173,961 (\$325,437 in 2007) as stock-based compensation.



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 12 - STOCK-BASED COMPENSATION (Continued)

As of December 31, 2008, the following stock options were outstanding:

Range of exercise prices	Number of outstanding options	Weighted average remaining contractual life (in years)	Weighted average exercise price \$
\$0.04 to \$0.06	65,000	9.83	0.04
\$0.07 to \$0.10	150,000	9.50	0.10
\$0.11 to \$0.15	1,750,000	9.42	0.12
\$0.16 to \$0.24	2,175,000	8.85	0.16
\$0.25 to \$0.36	1,000,000	8.33	0.32
\$0.37 to \$0.53	468,000	4.04	0.53
\$0.54 to \$0.78	100,000	7.88	0.63
\$0.79 to \$1.13	80,000	6.29	0.94
\$1.14 to \$1.65	1,085,000	5.79	1.38
<u>\$0.04 to \$1.65</u>	<u>6,873,000</u>	<u>8.09</u>	<u>0.40</u>

As of December 31, 2008, the following stock options were exercisable:

Range of exercise prices	Number of exercisable options	Weighted average exercise price \$
\$0.04 to \$0.06	18,959	0.04
\$0.07 to \$0.10	55,729	0.10
\$0.11 to \$0.15	645,833	0.12
\$0.16 to \$0.24	1,170,432	0.16
\$0.25 to \$0.36	725,000	0.32
\$0.37 to \$0.53	468,000	0.53
\$0.54 to \$0.78	78,125	0.63
\$0.79 to \$1.13	75,313	0.93
\$1.14 to \$1.65	1,085,000	1.38
<u>\$0.04 to \$1.65</u>	<u>4,322,391</u>	<u>0.55</u>

The vesting period may be as follows: a) over 36 months, with no more than a third of options vesting over 12 months, b) 25% of options upon signing and the balance over three years at a rate of one third per year, or c) 20% of options upon signing and the balance over three years at a rate of 30%, 25%, 25% respectively per year.

#### 13 - COMMITMENT

The Company has entered into a lease agreement, expiring on September 30, 2009, which calls for the payment of \$188,228 for the rental of premises.



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 14 - INFORMATION INCLUDED IN THE CONSOLIDATED STATEMENT OF OPERATIONS

	<u>2008</u>	<u>2007</u>
	\$	\$
Research and development expenses (1)	9,629,647	7,952,745
Amortization of property, plant and equipment	730,624	694,266
Amortization of intangible assets	62,767	72,600
Stock-based compensation	173,961	325,437
<u>Financial expenses</u>		
Interest income on held-for-trading assets	(286,228)	(576,119)
Interest on demand loan and convertible debentures	2,720,904	2,495,970
Exchange loss on operations	32,540	55,552
Exchange loss (gain) on the liability component of the convertible debentures	3,288,836	(2,583,761)
Other financial expenses	35,833	22,743
	<u>5,791,885</u>	<u>(585,615)</u>

(1) Research and development expenses are presented net of stock-based compensation, amortization of property, plant and equipment, and amortization of intangible assets.

#### 15 - FINANCIAL INSTRUMENTS

##### Risk Management Policies

The Company, through its financial assets and liabilities, is exposed to various risks. The following analysis provides a measurement of risks as of the balance sheet dates. The Company's financial assets and liabilities are its accounts receivable, its accounts payable and convertible debentures.

##### Fair Value

As of December 31, 2008 and 2007, the fair value of cash, accounts receivable and accounts payable and accrued liabilities approximates their carrying-amount given that they mature shortly. The fair value of the convertible debentures approximates the carrying-amount.

##### Credit Risk

The Company's recovery risk is linked to our partner located in Iceland. Management believes the recovery risk to be low due to the nature of our partner's business activities.

Financial assets that potentially subject the Company to credit risk consist of cash and cash equivalents, short-term investments and accounts receivable. As of December 31, 2008, the Company has cash and cash equivalents for an amount of \$221,495 (\$4,521,620 in 2007) with a reputable financial institution and \$896,684 (\$7,920,757 in 2007) in money market securities. Management assesses the Company's credit risk to be low.

##### Liquidity Risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at excessive cost. The Company's growth is financed on an annual basis through a combination of cash flows from operations, borrowings under the existing credit facilities and the issuance of equity. One of Management's primary goals is to maintain an optimal level of liquidity through the active management of assets and liabilities as well as cash flows.



## Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

### 15 - FINANCIAL INSTRUMENTS (Continued)

The convertible debentures will mature in March 2010 and the Company must pay interest every six months. Management assesses the Company's liquidity risk to be low, since its financial obligations may be met through the issuance of capital stock or other financial transactions (see Note 18).

#### Exchange Risk

The Company is exposed to currency risk due to its revenues and expenditures denominated in U.S. dollars. The Company has no currency hedging protection, the revenues in U.S. dollars being used to pay for purchases made in the said currency. Management assesses the Company's currency risk to be low.

As of December 31, 2008, the Company has assets and liabilities in foreign currency including cash and cash equivalents in the amount of US\$ 101,424 (US\$ 391,052 in 2007), accounts receivable in the amount of US\$ 0 (US\$ 58,367 in 2007), and accounts payable in the amount of US\$ 423,473 (US\$ 218,877 in 2007).

The Company is exposed to a currency risk on the repayment of the principal amount of the convertible debentures which shall be made at a fixed exchange rate of CAN\$ 1.2104 for each US\$ 1.00 (see Note 10). An exchange rate variation of 5% will generate a gain or (loss) of \$758,180.

#### Interest Rate Risk

The Company is exposed to interest rate risk on demand loan. Management does not believe that interest rate fluctuations will have a significant impact. In January 2009 the Company reimbursed the demand loan.

### 16 - CAPITAL STRUCTURE FINANCIAL POLICY

The Company's objectives when managing capital are to: 1) safeguard the Company's ability to pursue the development of its medical device products; 2) invest cash to earn the highest possible amount of interest income, and 3) maintain a flexible capital structure which optimizes the cost of capital at acceptable risk.

In the management of capital, the Company includes shareholders' equity, long-term debt, convertible debentures, tax credits receivable, and cash and cash equivalents. The Company manages the capital structure by reviewing on a weekly basis its use of cash and its short-term commitments related to its financial obligations.

In order to maximize ongoing development efforts, the Company does not declare dividends.

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

The Company does not have externally imposed capital requirements. However, the Company is subject to certain debt covenants in its credit facility agreement, which are measured on a quarterly basis. As of December 31, 2008, the Company is compliant with all debt covenant requirements, which are: i) minimum working capital ratio of 2/1; ii) minimum cash balance (including short-term investments) of \$1,700,000, and iii) minimum net equity (including convertible debentures) of \$5,000,000.

### 17 - SEGMENTED INFORMATION

The Company has two reportable operating segments, as defined in Note 1, which have been determined based on the fact that: 1) business decisions and internal performance analysis are made separately for each division; 2) specific devices are developed by separate teams for different markets; and 3) the Biotronix segment represents almost all of the Company's revenues.



## Victhom Human Bionics

### Notes to Consolidated Financial Statements

as of December 31, 2008 and 2007

#### 17 - SEGMENTED INFORMATION (Continued)

During 2008, the Company generated revenues from non-refundable advance royalties for an amount of \$2,185,618 (\$2,215,134 in 2007), from support activities for an amount of \$51,302 (\$33,774 in 2007), and from other sources for an amount of \$49,548 (\$22,692 in 2007). Revenues are mostly derived from a European medical device company located in Iceland.

Almost all of our property, plant and equipment are located in Canada.

The results of operations for the year are presented in the table below:

	Biotronix	Neurobionix	Total
	\$	\$	\$
<b>Revenues</b>	2,276,362	10,106	2,286,468
<b>Expenses</b>			
Research and development	2,283,053	9,161,630	11,444,683
Tax credits and grants	(398,426)	(700,356)	(1,098,782)
	<u>1,884,627</u>	<u>8,461,274</u>	<u>10,345,901</u>

#### 18 - SUBSEQUENT EVENTS

On April 30, 2009, the Company announced the execution of a partnership agreement to establish a joint venture with Otto Bock HealthCare GmbH ("Otto Bock") to develop and commercialize products currently being developed by Victhom's Neurobionix division.

As part of this transaction, Victhom will transfer all of the assets of its Neurobionix division to a newly created vehicle (the "JV") concurrent with an equity investment by Otto Bock of CAN\$ 30 million in the JV. The initial investment by Otto Bock will amount to CAN\$ 12.5 million and will result in the JV being owned, upon closing of this transaction, 55.6% by Otto Bock and 44.4% by Victhom. The partnership agreement also provides for additional equity contributions by Otto Bock of CAN\$ 17.5 million over the next 2 ½ years that will be mainly used to fund the development of the Neurostep<sup>®</sup> System but also the development of products in other indications.

The value of the investment by Victhom representing all assets of the Neurobionix division to be transferred to the JV has been established at CAN\$ 10 million. This investment will generate a gain of approximately CAN\$ 1.4 million. Victhom estimates that the carrying-amount of these assets will be CAN\$ 8.6 million, which are mainly composed of intangible assets and properties.

As a concurrent condition to the transaction with Otto Bock, Victhom will implement, by way of plan of arrangement under the Canada Business Corporations Act, the conversion of its 7% convertible debentures in the capital amount of CAN\$ 18.4 million maturing in March 2010 into a newly created class of preferred shares, on the basis of 12.5 preferred shares (pre-consolidation) per dollar of capital converted, and the consolidation of its common shares on a 10 for 1 basis. The transfer of the assets of the Neurobionix division will also be implemented by way of the plan of arrangement.

Victhom expects to hold separate debenture holders and shareholders meetings in early June to obtain certain required approvals for the above-mentioned plan of arrangement as well as the creation of the JV. Further details on the plan of arrangement and the transaction with Otto Bock will be provided in an information management circular expected to be distributed to its shareholders and debenture holders by mid-May. In addition to debenture holders and shareholders approvals, implementation of the JV transaction and the plan of arrangement is subject to approval by the Court under the Canada Business Corporations Act and receipt of all necessary regulatory and stock exchange approvals.

#### 19 - COMPARATIVE FIGURES

Some comparative figures have been reclassified to conform with the presentation adopted in the current year.