

Management's Discussion and Analysis ("MD&A")

February 19, 2010 / The following information should be read in conjunction with the Nuvo Research Inc. ("Nuvo" or the "Company") audited consolidated financial statements and notes for the year ended December 31, 2009 which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts in the MD&A, financial statements and related notes are expressed in Canadian dollars, unless expressed otherwise.

Forward-looking Statements

This MD&A contains forward-looking statements that are subject to risks and uncertainties beyond management's control. Actual results could differ materially from those expressed here. Risk factors are discussed more fully in the Company's Annual Information Form filed with the securities commissions in each Canadian province. Nuvo undertakes no obligation to revise forward-looking statements in light of future events.

Overview

Background

Nuvo is a publicly traded, Canadian drug development company, focused on the research and development of drug products that are delivered into and through the skin, primarily in the area of pain. Nuvo is also involved in research and development activities involving WF10, a chlorite-based, immunomodulating drug through its 60% interest in Dimethaid AG. The Company refers to and manages these activities as two distinct business and research segments: Pain, utilizing the Company's topical and transdermal drug delivery platform and Immunology, utilizing the Company's immune system regulation platform.

Pennsaid®, the Company's lead product, is used to treat the pain and symptoms associated with knee osteoarthritis ("OA"). Pennsaid combines a transdermal carrier (containing dimethyl sulfoxide, popularly known as "DMSO") with diclofenac sodium, a leading non-steroidal anti-inflammatory drug ("NSAID"), and delivers the active drug through the skin directly to the site of pain and inflammation. While, conventional oral NSAIDs expose patients to potentially serious systemic side effects such as gastrointestinal bleeding and cardiovascular risks, Nuvo's clinical trials suggest that some of these systemic side effects occur less frequently with topically applied Pennsaid. The Arthritis Foundation ("AF") estimates that nearly 27 million Americans are living with OA. The global OA prescription drug market is estimated to exceed US\$4 billion with anticipated growth to US\$7 billion by 2015.

Nuvo does not directly market Pennsaid in jurisdictions where the product has been approved. Instead, it enters into marketing and/or distribution agreements with third-party partners that have sales and marketing capabilities. Pennsaid has been approved for marketing and sale in a number of countries for several years, including Canada, several Caribbean nations and a number of European countries including Greece, Italy, Portugal and the United Kingdom. In the United States, the Company has been seeking marketing approval for several years. In early 2009, the Company filed a complete response amendment to address all of the U.S. Food and Drug Administration's ("FDA") concerns raised in their approval letter ("Approvable Letter") that was received in December 2006 and on November 4, 2009, the FDA approved Pennsaid, thereby permitting it to be sold and marketed in the U.S.

The Company and its subsidiaries employ a total of 69 full-time employees at the head office in Mississauga, Ontario, the Pennsaid manufacturing plant in Varennes, Québec, the OXO-K993 manufacturing plant in Wanzleben, Germany, its Nuvo Pain Group Office in West Chester, Pennsylvania and its research and development facilities in San Diego, California and Leipzig, Germany.

Vision

On September 21, 2004, following a proxy contest, the current Board of Directors was elected and a new President and Chief Executive Officer was appointed. The Board set Nuvo on a new course with its vision to build a profitable company focused on early to mid-stage drug development activities, from discovery through formulation and early stage clinical development, with the goal of outlicensing drug candidates at various stages of development prior to regulatory approval and the approval of the Pennsaid New Drug Application ("NDA") including all necessary studies. On December 1, 2009, subsequent to approval of the Pennsaid NDA by the FDA, the Board realigned the Company's management to better position the Company for future growth by appointing a president for each drug development group. Dr. Henrich Guntermann, formerly President & Chief Executive Officer of the Company was appointed President, Europe and Immunology Group and Dr. Bradley Galer was named President, Pain Group. Dan Chicoine, in addition to his role as Chairman of the Board of Directors and will serve as Co-Chief Executive Officer, John London, formerly Vice Chairman was named President and Co-Chief Executive Officer.

Pain

Topical and Transdermal Drug Delivery Platform ("TTDD")

Nuvo's TTDD platform is primarily used to develop drug products focused on the treatment of pain, particularly in cases where changing the dosage form of proven active drugs from oral to topical provides the possibility of clinical benefit, with reduced systemic exposure and fewer systemic side effects. Unlike oral medications, Nuvo's topical products do not rely on bloodstream circulation to reach affected parts of the body as they offer site-specific treatment while limiting systemic exposure to the active drug, thereby reducing the potential for negative side effects, adverse events and potential drug-drug interactions. Research studies conducted on behalf of the Company appear to confirm that using a transdermal carrier to deliver an effective pain relieving dose of diclofenac sodium results in significantly lower levels of diclofenac in the bloodstream, compared with published reports for diclofenac delivered orally.

Nuvo believes it is positioned to research and develop new drug product candidates for delivery into and through the skin.. First, Nuvo has discovered several penetration enhancer formulations, multiplexed molecular penetration enhancers ("MMPE™s"), that interact with the skin to modify its permeability; thereby allowing certain drug molecules to pass to and through the skin to proximate tissues. Second, Nuvo operates high throughput experimentation ("HTE") systems that allow its scientists to rapidly conduct experiments on combinations of existing molecular penetration enhancers ("MPE™s") and potential drug formulations to measure their ability to permeabilize and permeate the skin. Third, the Company has assembled a team of scientists, clinicians and other experts who have and continue to develop expertise in pain and TTDD.

While primarily focused on pain, the Company's TTDD platform also has practical application in the field of dermatology. While the Company remains focused on pain therapies, it will continue collaborations with third parties, directed towards either developing prospective products outside of its focus on pain or advancing its HTE capabilities. In 2008, the Company signed a research and development collaboration agreement with a Fortune Global 500 company. Under the

collaboration agreement, the Company has designed and constructed an HTE system to evaluate potential formulations for its partner's product portfolio.

The Company's drug development process involves applying its TTDD technologies and the expertise and experience of its scientists to formulate topical drugs using existing active pharmaceutical ingredients which have proven efficacy and safety. The targeted characteristics for each drug candidate may include improved delivery, reduced dosage or dosing frequency, lower systemic exposure, as well as significant commercial potential. The Company believes the development process for newly formulated topical versions of existing active pharmaceutical ingredients already approved by the FDA for other routes of administration can be shorter and less costly than that of a new chemical entity ("NCE"). Prior to conducting the required preclinical, pharmacokinetic and clinical work the Company's drug development and testing process involves: research on product specifications that need to be achieved to meet clinical and market requirements; extensive laboratory work including the selection of an appropriate MPE™ or MMPE™ for the targeted active pharmaceutical ingredient; defining the parameters of drug release in vitro; and, developing the final formulations to be tested in human clinical trials.

Pennsaid

Pennsaid, the Company's lead product, is used to treat the pain and symptoms associated with knee OA. OA is the most common joint disease affecting middle-age and older people. It is characterized by progressive damage to the joint cartilage and causes changes in the structures around the joint. These changes can include fluid accumulation, bony overgrowth, and loosening and weakness of muscles and tendons, all of which may limit movement and cause pain and swelling. The drug combines the transdermal carrier DMSO with diclofenac sodium, a leading NSAID, and delivers the active drug through the skin directly to the site of pain. While conventional oral NSAIDs expose patients to potentially serious systemic side effects such as gastrointestinal bleeding and cardiovascular risks, Nuvo's clinical trial results suggest that some of these systemic side effects occur less frequently with topically applied Pennsaid.

Pennsaid has been approved for marketing and sale in a number of countries, including the U.S., Canada, the U.K., several Caribbean nations and certain European countries.

Based on data from national and regional surveys and applying these to 2005 U.S. Census data the American College of Rheumatology ("ACR") reported that more than 21% of U.S. adults (46.4 million persons) were found to have self-reported doctor-diagnosed arthritis. This number is expected to increase by 40% to nearly 67 million over the next 25 years. In adults, arthritis is one of the leading causes of disability and is among the most common conditions resulting in work limitations. According to the AF most Americans are unaware of the seriousness of arthritis and the substantial negative impact it can have on an individual's quality of life and use of health-care resources. They estimate that it costs the U.S. economy more than US\$128 billion annually. According to the AF, knee OA, the most frequent form of lower extremity arthritis, contributes to 418,000 knee replacement procedures annually and in 2006 accounted for US\$19 billion in hospital charges.

In the U.S., a number of existing pharmaceutical products treat the pain associated with OA. These products include: over-the-counter oral medications that are accessible without a doctor's prescription, such as acetaminophen and low-dose NSAIDs (Advil®, Motrin®, Aleve®); oral, full-dose, NSAIDs which are available only by prescription; oral COX-2 selective NSAIDs which are available only by prescription; oral narcotics, such as opioid analgesics which are available only

by prescription; and, topical NSAIDs which have only been available since 2008 by prescription only.

The Company has been seeking FDA approval to sell and market Pennsaid in the U.S. for several years. The Company's initial submission for FDA approval to market Pennsaid in the U.S. was made in 2001. In August 2002, in response to the Company's initial NDA for Pennsaid, the FDA sent the Company a non-approvable letter (the "Non-Approvable Letter"), detailing a number of deficiencies in the Company's application. In consultation with the FDA, the Company designed two new Phase 3 clinical trials, a 12-week efficacy trial and a long-term safety trial and conducted a pharmacokinetic study providing more information on DMSO in order to address the deficiencies cited by the FDA in the Non-Approvable Letter. The Company successfully completed all required trials and submitted a complete response amendment to the FDA in June 2006.

On December 28, 2006, Nuvo received an Approvable Letter from the FDA for Pennsaid. In its letter, the FDA indicated that Pennsaid is approvable subject to Nuvo satisfying certain conditions including the provision of additional nonclinical dermal safety and packaging data. None of the conditions in the Approvable Letter related to the clinical efficacy or the clinical safety of Pennsaid. Furthermore, none of these conditions had been raised by the FDA in the Non-Approvable Letter of August 2002. The FDA did not request that Nuvo conduct any additional Phase III clinical trials as a condition of approval.

During 2007, the Company engaged in communications with the FDA to clarify the Agency's expectations regarding certain of its requirements in the Approvable Letter for additional information relating to Pennsaid. Based on the contents of the Approvable Letter and these clarifications, the Company completed several studies (the "Approvable Studies") including two toxicology studies (the "Tox Studies"). In addition, the Company concluded it must complete a two (2) year dermal carcinogenicity study (the "Carc Study") preceded by a dose finding trial to confirm the dermal and systemic safety of Pennsaid. The FDA confirmed in written minutes of a telephone meeting with the Company, that the Carc Study could be completed post approval, provided no safety concerns were identified in the Tox Studies.

On February 4, 2009, the Company filed a complete response amendment to address all of the FDA's concerns raised in the Approvable Letter and the FDA set August 5, 2009 as the date pursuant to the Prescription Drug User Fee Act ("PDUFA Date") by which it would advise Nuvo of their decision regarding Pennsaid's approvability. During the review process, Nuvo provided the FDA with supplemental information, which the FDA determined to be a major amendment to the Pennsaid NDA. As a result, the FDA extended the PDUFA Date by three months to November 4, 2009. On November 4, 2009, the FDA approved the NDA for Pennsaid permitting it to be sold and marketed in the United States. Upon FDA approval of Pennsaid in the United States, the product received a three-year period of marketing exclusivity from the date of approval pursuant to a 1984 United States federal law, the Drug Price Competition and Patent Term Restoration Act, informally known as the "Hatch-Waxman Act", and Code of Federal Regulations ("C.F.R.") 314.108(b)(4) which provide that a product filed as a 505(b)(2) application and supported by sponsor initiated clinical studies required as a condition of approval is entitled to three years of marketing exclusivity starting from the effective date of approval. This period of marketing exclusivity would prohibit the sale of generic versions of Pennsaid in the United States for three years from the effective date of approval. After the expiration of market exclusivity, a generic version of Pennsaid could be sold in the United States, if such generic version was approved by the FDA. The approval included several post-approval commitments including the completion of

the Carc Study and two DMSO based studies all of which will be conducted and paid for by Covidien.

During the FDA review period, on June 15, 2009, the Company entered into a U.S. License and Development Agreement (“U.S. Licensing Agreement”) with Mallinckrodt, Inc., a subsidiary of Covidien plc (“Covidien”) granting Covidien exclusive rights to market and sell Pennsaid and Pennsaid Plus as fully described later in this MD&A in the section entitled “Significant Transactions – 2009 – Pennsaid U.S. Licensing Agreement and FDA Approval”.

Pennsaid Plus

The Company began exploring formulations to improve upon the original Pennsaid formulation in late 2004. The Company has completed preliminary testing of a new, improved version of Pennsaid, currently referred to as Pennsaid Plus. While no clinical trials of this product have taken place to date, in vitro and in vivo testing have indicated that Pennsaid Plus may increase the transport of diclofenac, the active therapeutic drug in both original Pennsaid and Pennsaid Plus, through the skin with less frequent dosing than Pennsaid. The development of Pennsaid Plus is an important step in the Company’s plan to develop a family of topically applied drugs with applications in a number of therapeutic areas. The Company has filed patent applications for improved versions of Pennsaid including Pennsaid Plus.

Pennsaid Plus is not currently approved for sale or marketing in any jurisdiction. The Company has had meetings with the FDA at which the FDA’s information requirements for the approval of Pennsaid Plus were discussed. Based on the Company’s meeting with the FDA in 2008, it was decided that two pivotal phase 3 clinical trials would be required to demonstrate the clinical efficacy of Pennsaid Plus. Under the terms of the U.S. Licensing Agreement, Covidien has assumed all responsibility for planning, executing and funding all development activities for Pennsaid Plus, but the parties did agree on the planned development program. Although, Nuvo has been provided two seats on the joint steering committee (“JSC”) under the terms of the U.S. Licensing Agreement, the Company will not control the clinical development program for Pennsaid Plus. The current Pennsaid Plus development plan includes a Phase 2 trial that Covidien expects to commence in 2010 and two Phase 3 trials that are expected to commence thereafter in 2011.

Additional clinical and non-clinical studies may be required to support applications for the regulatory approval of Pennsaid Plus in the U.S. and other jurisdictions in which the Company could potentially market the product. In the United States, Covidien is responsible for the implementing the development plan for all clinical and non-clinical studies in support of FDA approval. There can be no assurance that such trials will be sufficient for regulatory authorities or that studies will yield successful results or that the required regulatory approvals will be obtained. If approved for sale and marketing, the Company believes that Pennsaid Plus will be more desirable than Pennsaid, as it is anticipated that less frequent dosing will offer improved patient compliance and ease of use while providing the same OA symptom relief as Pennsaid.

Early Stage Drug Development

In addition to Pennsaid and Pennsaid Plus, the Company is actively conducting research on formulations utilizing its HTE technology platforms and its MPE™ systems to build its topical and transdermal drug candidate pipeline. The Company is focusing the majority of its research in the area of pain. A number of formulations are under research or in early stage preclinical development.

In the field of pain, in addition to Pennsaid and Pennsaid Plus, Nuvo is developing topical medications for a variety of pain conditions including acute and chronic pain of inflammatory, nociceptive and neuropathic origin. All of these pain medications will be designed to treat the pain locally while limiting systemic exposure to the active drug thereby, reducing the potential for negative side effects, adverse events and potential drug-drug interactions. The drug product candidates under development are at various stages of formulation and preclinical development.

In the field of dermatology, Nuvo's research has been directed towards a topical antifungal drug candidate, intended for use in treating onychomycosis, a nail fungal infection that resides in both the nail and nail bed.

Immunology

Immune System Regulation ("ISR")

The immune system provides an essential defence to micro organisms, cancer and substances it sees as foreign and potentially harmful. The Company's ISR platform, WF10, a solution of OXO-K993, focuses on supporting the immune system and returning it to normal immune function. ISR research is carried out through Nuvo Research GmbH and its parent company, Dimethaid AG, in which the Company has a 60% interest.

WF10

WF10 supports the immune system. In this system, normally functioning macrophages alternate between one of two basic states: phagocytic and inflammatory. Phagocytic macrophages digest invading organisms, such as viruses, and initiate a biological pathway leading eventually to a switch to the inflammatory state. Inflammatory macrophages, in turn, induce a variety of reactions - fever, sweating, swollen glands, malaise and appetite loss - the common, uncomfortable signs of illness. This response, while entirely normal, must be turned on and off in a controlled manner. If left unchecked, pathogens can overdrive the immune system toward the inflammatory state creating an imbalance that may lead to such medical disorders as chronic inflammation, immune deficiency, organ damage and tumour proliferation. The drug has potential applications in adjuvant cancer therapy, diseases related to immune deficiencies and the management of chronic viral infections.

In 2006, the Company commenced a Phase 2 trial using WF10 as an adjuvant treatment for inoperable pancreatic cancer at the University of Heidelberg and the National Centre for Tumor Diseases in Germany. Enrolment was planned to include up to 43 patients with advanced, inoperable cancer who would receive oral capecitabine (Xeloda®), a chemotherapeutic drug currently used in cancer treatment, with WF10 co-therapy.

In December 2008, the Company terminated its Phase 2 clinical trial for inoperable pancreatic cancer. Preliminary results of an interim analysis indicated that the primary end point, greater than six months survival, was successfully achieved. However, it was unclear, based on the study design and the data reviewed whether the positive results could be confirmed in a placebo controlled study. The Company will complete its analysis of the interim study results in early 2010 and determine based on the results of the analysis, the best path forward for this potential WF10 indication. In addition, discussions between the Company and both the University of Heidelberg and the National Centre for Tumor Diseases are ongoing as the data is analyzed and the best path forward determined.

In 2009, the Company received funding commitments of up to \$3.3 million (€2.2 million) from the Development Bank of Saxony ("SAB") for two co-operative drug development projects with the

Fraunhofer Institute for Cell Therapy and Immunology IZI (“Fraunhofer Institute”) in Leipzig, Germany. These two projects will focus on the preclinical and clinical development of WF10 as a potential treatment for allergic rhinitis and rheumatoid arthritis. In 2010, subject to the approval from Germany’s Federal Institute for Drugs and Medical Devices (Bundesinstitut für Arzneimittel und Medizinprodukte) (“BfArM”), the German regulatory authority, the Company plans to initiate a Phase 2 trial studying WF10 as a potential treatment for allergic rhinitis.

Research suggests that in some cases, WF10 may rebalance improperly functioning immune systems, such that it may be effective for the treatment of conditions such as allergic rhinitis where the body’s immune system inappropriately responds to the presence of foreign allergens and rheumatoid arthritis where autoimmunity plays a pivotal role in the progression of cartilage destruction in the joints.

Oxoferin™

Oxoferin™, a topical wound healing agent, is a diluted form of WF10. By activating macrophages, Oxoferin™ appears to stimulate the proliferation of fibroblasts-cells that manufacture connective tissue. New connective tissue leads to contraction, closure and faster healing of wounds. Chronic, hard-to-heal wounds are a serious problem with an increasing incidence. Chronic wounds can be caused by such conditions as pressure sores and poor circulation in the lower extremities. Co-morbid conditions, such as diabetes and atherosclerosis, reduce blood flow to the extremities and also increase the likelihood of developing chronic wounds.

In 2002, there was an estimated six million chronic wound cases in the U.S and the incidence of these wounds is increasing at approximately 10% per year. In 2004, some 71,000 people lost a foot or leg to complications from diabetes. Currently, it is estimated that the sales value of the advanced wound care market worldwide is approximately \$4 billion, and continues to grow at approximately 10% per year.

Oxoferin™ is marketed by the Company’s European subsidiary and its distributors in parts of Europe, Asia and South America as a topical wound healing agent under several trade names including Oxoferin™ and Oxovasin®.

In 2008, the Company signed a distribution and license agreement with a regional pharmaceutical company for Russia and some of the former Soviet republics including all of the Baltic States. The Company and its licensee are currently working to gain marketing authorizations in these territories, but do not expect to receive such authorizations until late 2010 at the earliest.

In 2009, the Company signed a distribution and license agreement with Ranbaxy Laboratories Limited (“Ranbaxy”) for Singapore, Malaysia, Philippines, Vietnam and other Indochina countries. The Company and its licensee are currently working to gain marketing authorizations in these territories, but do not expect to receive such authorizations until 2011 at the earliest.

As the Company’s patents associated with Oxoferin™ have expired, the Company is exploring improved formulations of this product.

Intellectual Property

The pharmaceutical industry is a highly competitive sector where long-term success depends upon developing safe and effective proprietary products. Nuvo has the products and

technologies, but in the case of its marketed drugs, Pennsaid and Oxoferin™, it no longer has the desired patent protection.

Upon FDA approval of Pennsaid in the U.S., the product received a three-year period of marketing exclusivity from the date of approval pursuant to a 1984 United States federal law, the Drug Price Competition and Patent Term Restoration Act, informally known as the "Hatch-Waxman Act", and C.F.R. 314.108(b)(4) which provide that a product filed as a 505(b)(2) application and supported by sponsor initiated clinical studies required as a condition of approval is entitled to three years of marketing exclusivity starting from the effective date of approval, November 4, 2009. This period of marketing exclusivity would prohibit the sale of generic versions of Pennsaid in the U.S. for three years from the effective date of approval. After the expiration of market exclusivity a generic version of Pennsaid could be sold in the United States if such generic version was approved by the FDA.

The European Pennsaid patent (covering Austria, Belgium, France, Germany, Italy, Liechtenstein, Luxembourg, Netherlands, Sweden, Switzerland and the United Kingdom) expired in June 2006. In Italy, the Company has a Supplementary Protection Certificate that extends the life of this patent until March 2011.

Developing patent protection for its platforms and future products is a key driver for the long-term success of Nuvo. With this goal in mind, the Company has acquired patents, patent rights and applied for patents to protect its early stage drug development candidates in the field of pain and dermatology.

Manufacturing

Nuvo's long-term business strategy does not include manufacturing and management expects to rely on partners or contracted third parties for the production of drug products developed in the future. However, as the Company already has production facilities for its current commercial drugs, Pennsaid and Oxoferin™, management has decided to continue operating its own manufacturing facilities for the foreseeable future.

In February 2000, the Company acquired its existing Pennsaid manufacturing facility in Varennes, Québec, with manufacturing, bottling and packaging capabilities and a research laboratory. In 2009, the plant passed an FDA, pre-approval manufacturing inspection as part of the U.S. Pennsaid NDA review. In July 2009, the plant was inspected by Health Products and Food Branch Inspectorate ("HPFBI") and was found to be compliant with Canadian Drug Good Manufacturing Practices ("GMP") requirements. The facility remains in compliance with current GMP regulations and is the site for commercial production of Pennsaid worldwide.

In 2009, the Company increased production capacity at Varennes with the installation of additional compounding, filling and packaging equipment. This equipment is expected to provide the Company with adequate capacity to meet Covidien's anticipated demand for Pennsaid in the U.S.

In 2009, the Company continued to pursue select contract manufacturing opportunities to utilize excess production capacity. However, with the plant focused on the supply of Pennsaid for the U.S. launch, it will not be pursuing other contract manufacturing opportunities in the foreseeable future.

The Company also owns a 3,000 square-foot manufacturing facility in Wanzleben, Germany, acquired in May 2002 as part of the Oxo Chemie acquisition. This plant produces OXO-K993, the active ingredient in WF10 and Oxoferin™.

Capability to Deliver Results

Nuvo will need to spend considerable resources on research and development to advance current and future drug products utilizing its technology. The Company may finance these activities through: existing cash and cash equivalents; revenues generated by product sales, royalties and sales milestones from Pennsaid or Pennsaid Plus; licensing and co-development agreements for other new drug candidates in the U.S. and other territories; or by raising funds in the capital markets.

In addition to devoting its own resources, Nuvo plans to work with partners earlier in the development process to leverage their experience and financial and intellectual capabilities. At this time, with the exception of the Covidien relationship for developing Pennsaid Plus, Nuvo does not have any drug development partnerships in place. The Company has commercial partners in the U.S., Canada, Greece and Italy for sales and marketing of Pennsaid and in India, Indonesia, Pakistan, Thailand, Venezuela, Russia, Malaysia, Philippines, Vietnam and other Indochina countries for Oxoferin™.

The Company's scientific, clinical and regulatory teams have excellent capabilities and have successfully taken a product from the lab to approval. To execute the current business plan, the Company will selectively add key personnel to its existing internal staff and may need to hire more staff in the future as activities expand. In addition, the Company has access to the regulatory and scientific expertise of its Scientific and Pain Products Advisory Boards to assist it through all aspects of the drug development process.

Goals

In order to achieve the Company's "vision" of becoming a leader in the research and development of drug products that are delivered into and through the skin, initially focusing on pain, the Company reorganized its executive management team subsequent to FDA approval to more effectively execute on the expansion and development of its drug candidate pipeline as discussed under the section entitled "Vision".

For 2010, the Company will focus on three main goals: supporting Covidien in its launch of Pennsaid in the U.S.; advancing the drug development pipeline, primarily in pain; and, conducting and completing the WF10 allergic rhinitis proof of concept trial while at the same time effectively managing the Company's cash resources.

Liquidity

The Company has incurred substantial losses since its inception, as it has invested significantly in drug development activities and other legacy ventures. At December 31, 2009, the Company has an accumulated deficit of \$185.3 million. Although the Company had net income of \$15.0 million in 2009, it included \$27.3 million of Pennsaid milestone and licensing payments received pursuant to the U.S. Licensing Agreement with Mallinckrodt Inc., a subsidiary of Covidien that will not recur. At December 31, 2009, the Company had cash and cash equivalents of \$42.1 million.

The Company expects that it will continue to incur losses as it expands research and development activities and its pipeline and awaits the launch of Pennsaid in the U.S. Its ability to continue as a going concern depends on the successful launch of Pennsaid in the U.S. as it will earn royalties and sales milestone payments based on net sales and its ability to secure additional licensing fees, secure co-development agreements and gain regulatory approval for other drugs and ultimately achieve profitable operations. For 2010, the Company currently anticipates that its cash and cash equivalents together with the revenues it expects to generate from product sales, royalty payments from its U.S. Licensing Agreement and interest it expects to earn on invested funds will be sufficient to execute its plan and fund operations.

Nonetheless, companies in the pharmaceutical research and development industry typically require periodic funding in order to develop drug candidate pipelines until such time as successful commercialization of at least one drug candidate and are receiving sufficient revenue to fund their operations. Nuvo has not yet reached this stage and therefore, the Company monitors on a regular basis, its liquidity position, the status of its drug development programs, including cost estimates for completing various stages of development, the scientific progress on each drug candidate, the potential to license or co-develop each drug candidate and continues to actively pursue fund-raising possibilities through various means, including the sale of its equity securities. There can be no assurance, especially considering the economic environment, that additional financing would be available on acceptable terms, or at all, when and if required. If adequate funds were not available when needed, the Company may have to substantially reduce or eliminate planned expenditures, delay preclinical studies for its product candidates, reduce staff and curtail product development programs. If the Company is unable to obtain additional financing when and if required, the Company may be unable to continue operations.

The consolidated financial statements do not include adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

Changes in and New Accounting Policies

Changes in Accounting Policies

Goodwill, Intangible Assets and Financial Statement Concepts

On January 1, 2009, the Company adopted new *Handbook Section 3064, Goodwill and intangible assets*, replacing *Handbook Section 3062, Goodwill and other intangible assets* and *Handbook Section 3450, Research and development costs*. The Canadian Institute of Chartered Accountants ("CICA") also amended *Handbook Section 1000 Financial Statement Concepts* to provide consistency with this new standard. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and intangible assets by profit-oriented enterprises. This section clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset and as a result start-up costs must be expensed as incurred. The provisions relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions of International Financial Reporting Standards ("IFRS") *IAS 38 Intangible Assets*. Upon adoption, there was no impact on the Company's consolidated financial statements.

Credit Risk and the Fair Value of Financial Assets and Liabilities

In January 2009, the CICA's Emerging Issues Committee ("EIC") issued abstract *EIC-173, Credit and the Fair Value of Financial Assets and Liabilities*, which requires entities to take both counterparty credit risk and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives. EIC-173 came into effect for interim and annual periods beginning on or after January 1, 2009. Upon adoption, there was no impact on the Company's consolidated financial statements.

Financial Instruments Disclosures

In June 2009, the CICA amended *Section 3862, Financial Instruments – Disclosures*, to include additional disclosure requirements about fair market value measurements for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. This new standard became effective for the Company on December 31, 2009. The Company has assessed its financial instruments that are reported at market value, cash and cash equivalents and restricted cash, and determined that they are Level 1 valuations.

New Accounting Policies

Deferred Share Unit Plan ("DSU Plan")

On January 1, 2009, the Company established the DSU Plan, a share-based compensation plan for non-employee directors. Under this DSU Plan, non-employee directors can be allotted and can elect to receive a portion of their annual retainers and other Board-related compensation in the form of DSUs. One DSU has a cash value equal to the market price of one of the Company's Common Shares. DSUs that are intended to be settled in cash are recorded as liabilities. Upon issuance, the fair value of the DSUs is recorded as compensation expense and a corresponding liability (the "DSU Accrual") is established using the underlying value of the common shares. At all subsequent reporting dates, the DSU Accrual is adjusted to the market value of the underlying shares and the adjustment is recorded as compensation cost. Forfeitures of awards are accounted for in the period when they occur. This policy was adopted by the Company upon establishment of the DSU Plan.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Management has identified the following accounting policies that it believes require the application of management's most subjective judgments, often requiring the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. The Company's actual results could differ from these estimates and such differences could be material. All significant accounting policies are disclosed in Note 2, "Summary of Significant Accounting Policies", of the consolidated financial statements.

Revenue Recognition

The Company recognizes revenue from product sales, research and development collaborations and licensing arrangements which may include multiple elements. Revenue arrangements with multiple elements are reviewed in order to determine whether the multiple elements can be divided into separate units of accounting, if certain criteria are met. If separable, the consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. If not separable, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

Revenue from product sales is recognized upon shipment of the product to the customer provided transfer of title to the customer occurs upon shipment and provided the Company has not retained any significant risks of ownership or future obligations with respect to the product shipped, the price is fixed and determinable and collection is reasonably assured. Where applicable, revenue from product sales is recognized net of reserves for estimated sales discounts and allowances, returns, rebates and charge backs.

For upfront, non-refundable payments received in accordance with the execution of licensing and collaboration agreements, distribution agreements and supply agreements revenue is deferred and recognized over the performance period, the period over which the Company maintains substantive contractual obligations. If the Company cannot reasonably estimate when its substantive contractual obligations cease, then the revenue is deferred indefinitely. Once a reasonable estimate can be made, the amount deferred is recognized as revenue in accordance with the policy described above. Amounts the Company expects to earn in the current year are included in the current portion of deferred revenue and amounts expected to be earned in subsequent periods are included in deferred revenue. The term over which upfront fees are recognized can be revised if the period over which the Company maintains substantive contractual obligations changes.

Milestone payments are immediately recognized as licensing revenue when the condition is met, the milestone is not a condition to future deliverables and collectability is reasonably assured. Otherwise, they are recognized over the remaining term of the agreement or the performance period.

Revenues from research and development collaborations are generally recognized as the contracted services are performed and the related expenditures are incurred pursuant to the terms of the agreement and provided collectability is reasonably assured. Amounts received in advance of recognition are included in deferred revenue.

Valuation Allowance for Future Tax Assets

The Company recorded a valuation allowance on future tax assets primarily related to non-capital operating loss carryforwards, scientific research and development expenditure pool carryforwards, investment tax credits and differences between the tax and accounting basis of capital assets. Management has assumed that the related tax benefits are not more likely than not to be realized based on the Company's historical results, its estimated future taxable income and its tax planning strategies in the relevant jurisdictions. The implementation of tax planning strategies or the generation of future taxable income in these jurisdictions could result in the recognition of some portion or all of these future tax assets, which could have a material impact on the Company's results of operations through the recovery of future income taxes.

Stock-Based Compensation and other Equity-Based Instruments

The Company accounts for stock option awards granted after June 1, 2002 under its stock option plan using the fair value method. The fair value of stock options at the grant date is determined using the Black-Scholes option pricing model and expensed over the vesting period of the options. To determine the fair value, management must make assumptions about the volatility and expected dividend yield on the underlying stock and estimate the expected life for each option granted. In addition, for performance based options, management must determine if achievement of the vesting milestones are likely, when they are expected to occur and the level of forfeitures.

In addition, whenever the Company issues other equity-based instruments, such as common share purchase warrants, agent's compensation options, underwriter warrants or debt instruments not issued at fair value and containing equity features, the Company must also determine their fair value using the Black-Scholes options pricing model.

Impairment of Long-Lived Assets

Property, plant and equipment and other long-lived assets including intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In addition, goodwill and intangible assets with infinite lives are subjected to an annual impairment test. The recoverability of long-lived assets is determined by evaluating whether the carrying value of such assets can be recovered from estimated undiscounted future operating cash flows and as such requires us to make significant estimates on expected revenues from the commercialization of our products and services and the related expenses. When an asset is impaired, according to the foregoing test, an impairment loss is measured and recognized as the excess of the carrying value of the asset over its fair value.

In December 2008, the Company conducted a review of its portfolio of potential drug candidates. This review resulted in changes to the Company's drug development strategy that included, among other things, revised development timelines for certain drug candidates, reprioritizing the importance of specific drug candidates for development and identifying new drug candidates. Subsequent to this review, the Company assessed the impact of these drug development strategy changes on the recoverability of the carrying values of each of its intangible assets. Based on its assessment, it was determined that the carrying value of certain patents would not be recoverable and, therefore, an impairment charge of \$198,000 was recorded to income.

Despite the Company's going concern uncertainty, management did not deem it necessary to write-down any of its property, plant and equipment. Management believes the Company should be able to obtain additional financing to allow it to pursue its activities until profitability is achieved and positive cash flow is generated. However, there can be no assurance that the Company will be able to raise such capital on favourable terms or at all or that the launch of Pennsaid in the United States will be successful or that it will receive payments under existing agreements.

Foreign Currency Translation

Transactions undertaken in foreign currencies are translated into an entities functional currency at exchange rates prevailing at the time the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency of the entity at the exchange rate prevailing on the Consolidated Balance Sheet dates. Non-monetary assets and liabilities are translated at historical exchange rates. Exchange gains and losses are included in the Consolidated Statements of Income (Loss).

All subsidiaries are considered to be integrated operations and are translated into Canadian dollars using the temporal method; consequently all monetary assets and liabilities are remeasured at the exchange rate prevailing at the Consolidated Balance Sheet dates. Non-monetary assets and liabilities are measured at historical exchange rates. Revenue and expense items are measured at the average rate of exchange in effect during the period in which they occur, except for amortization expense which is measured at the historic exchange rate of the applicable asset. Resulting gains and losses are included in the Consolidated Statements of Income (Loss) during the period in which they occur.

Contingencies

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with licensees, distributors, suppliers, former employees and other parties. Management believes that adequate provisions have been recorded in the accounts where required. The Company is currently involved in litigation and other matters in which the extent of potential costs and losses, should the Company be unsuccessful in its defence of the matters, could have a material adverse effect on the consolidated financial position of the Company. See the section entitled "Litigation" for a complete discussion of these matters.

Selected Financial Information

in thousands (except per share and share information)

	Year ended December 31, 2009	Year ended December 31, 2008	Year ended December 31, 2007
<i>Operations</i>			
Product sales	\$ 8,795	\$ 8,008	\$ 5,933
Cost of goods sold	5,534	4,809	4,391
Gross margin on product sales	3,261	3,199	1,542
License fees	29,553	2,514	1,000
Research and other contract revenue	299	205	245
	33,113	5,918	2,787
Operating expenses	18,095	17,031	15,699
Income (loss) from operations	15,018	(11,113)	(12,912)
Other income	-	561	536
Net Income (loss)	\$ 15,018	\$(10,552)	\$(12,376)
<i>Share Information</i>			
Income (loss) per share – basic and diluted	\$ 0.04	\$ (0.03)	\$ (0.05)
Average number of common shares outstanding for the year (in millions)			
Basic	363.4	306.3	243.1
Diluted	400.2	306.3	243.1
<i>Financial Position</i>			
Cash and cash equivalents	\$ 42,102	\$ 15,219	\$ 21,791
Total assets	48,550	21,435	28,647
Deferred revenue, including current portion	3,321	5,562	6,380
Long-term debt, debentures and capital lease obligations, including current portions	3,182	5,275	2,822
Total liabilities	11,092	13,573	12,783
Total shareholders' equity	37,458	7,862	15,864

Non-GAAP Financial Measure

Income (loss) from operations is a non-GAAP financial measure that does not have a standardized meaning prescribed by GAAP. However, the Company believes that the income (loss) from operations is a useful measure as it provides investors with an indication of the performance of the Company before considering gains or losses from non-recurring transactions including loss on the extinguishment of the convertible debentures, change in estimate in contingency and gain on sale of assets.

Fluctuations in Operating Results

The Company's results of operations have fluctuated significantly from period-to-period in the past and are likely to do so in the future. The Company anticipates that its quarterly and annual results of operations will be impacted for the foreseeable future by several factors, including the timing and amount of payments received pursuant to current and future collaborations including the U.S. Licensing Agreement, and the progress and timing of expenditures related to research, development and commercialization efforts. Due to these fluctuations, the Company believes that the period-to-period comparisons of its operating results are not necessarily a good indicator of future performance.

Significant Transactions

2009

Pennsaid U.S. Licensing Agreement and FDA Approval

On June 15, 2009, (the "Effective Date") the Company entered into the U.S. Licensing Agreement with Covidien, granting Covidien exclusive rights to market and sell Pennsaid in the United States through the transfer of the NDA to Covidien upon FDA approval in the United States. Under the terms of the agreement, Nuvo received a non-refundable, upfront payment of \$11.3 million (US\$10.0 million) (the "Initial Payment") upon signing the U.S. Licensing Agreement. Upon FDA Approval in November 2009, the Company received a \$16.0 million (US\$15.0 million) milestone payment (the "FDA Approval Payment") and shortly thereafter transferred ownership of the Pennsaid NDA to Covidien. Under the terms of the U.S. Licensing Agreement, Covidien assumed responsibility for all development activities and costs related to Pennsaid subsequent to the Effective Date and subsequent to the transfer of the NDA all regulatory responsibility. As the Company had no substantive contractual obligations remaining after the transfer of the NDA, these payments were recognized as revenue and included in other revenue – licensing fees in 2009.

In addition, under the terms of the U.S. Licensing Agreement, Nuvo is eligible to receive payments for royalties on net U.S. sales of Pennsaid and escalating sales milestone payments for the products totaling up to US\$100 million.

Covidien has agreed to support the launch of Pennsaid in the U.S. by committing to a predetermined level of sales representation during the first three years of launch and to specified levels of promotional spending both prior to and subsequent to product launch.

Under the terms of the U.S. Licensing Agreement, Covidien assumed responsibility for managing, planning, executing and paying for all development activities for Pennsaid's follow-on product Pennsaid Plus subsequent to the Effective Date. If Pennsaid Plus is approved by the FDA, Nuvo would be entitled to receive royalties and escalating sales milestone payments.

All costs reimbursed or recovered from Covidien for Pennsaid and Pennsaid Plus are reflected as reductions to research and development expenses for the year ended December 31, 2009.

Nuvo will manufacture and supply Pennsaid and Pennsaid Plus to Covidien under the terms of the U.S. Licensing Agreement.

Subsequent to completing the U.S. Licensing Agreement, on November 4, 2009, the FDA approved the NDA for Pennsaid permitting it to be sold and marketed in the United States. As a result of the approval, in addition to receiving the \$16 million FDA Approval Payment, the Company incurred \$0.6 million of costs directly related to the approval including: \$0.1 million, representing a 0.5% royalty payable to Paladin under the terms of New Canadian Licensing Arrangements (see Significant Transactions – 2008 – New Canadian Licensing Arrangements); and a \$0.5 million milestone payment related to proprietary research.

2008

New Canadian Licensing Arrangements

On July 7, 2008, the Company and its Canadian distributor Paladin Labs Inc. (“Paladin”), reached an agreement to amend and restate the Pennsaid and Pennsaid Plus licensing, supply and other arrangements (the “Amended and Restated Canadian Licensing Arrangements”). Under the terms of this agreement, Paladin made payments to the Company totaling \$2.5 million as follows:

- \$0.6 million in full settlement of the amount receivable from Paladin relating to Ontario Innovation Tax Credit (“OITC”) refunds;
- \$0.9 million to settle obligations under the original licensing arrangements incurred prior to July 7, 2008, but which had not previously been considered earned by the Company as the amounts were only payable by Paladin upon the attainment of certain future performance targets for Pennsaid in Canada, the achievement of which could not be reasonably estimated up to the point of executing the new licensing, supply and other arrangements; and,
- \$1.0 million as a prepayment of future royalties relating to Canadian sales of Pennsaid for the period from July 7, 2008 through December 31, 2010.

Under the terms of the new Pennsaid licensing arrangements, the length of the term was increased to 99 years and now ends in August 2104, the Company relinquished the right to share in certain future operating revenues in excess of target amounts and the Company no longer has an ongoing obligation relating to the market performance of Pennsaid in the Canadian market that could have resulted in payments to Paladin. Effective January 1, 2011 and until the end of the term, Paladin will pay the Company a royalty based upon Canadian sales of Pennsaid.

Under the amended and restated Pennsaid Plus license agreement, Paladin acquired the rights to market Pennsaid Plus in some additional territories, including South Africa and Israel, (the “Additional Territories”) and will pay the Company royalties on future sales of Pennsaid Plus in Canada and these additional territories and a potential milestone payment. Additionally in 2009, under the terms of this agreement, the territories of Central and South America were added to the Additional Territories as the Company did not license these territories to Covidien by December 31, 2009.

On July 7, 2008, in connection with the Amended and Restated Canadian Licensing Arrangements, Paladin invested \$2.0 million in Nuvo by way of a two-year convertible debenture (the “Paladin Debenture”). The Paladin Debenture was converted into common shares of the Company in 2009.

Results of Continuing Operations

Product Sales and Gross Margin

in thousands (except gross profit percentage)

	Year ended December 31, 2009	Year ended December 31, 2008
Pennsaid sales	\$ 7,958	\$ 6,956
WF10 sales	775	962
Contract manufacturing sales	62	90
Total product sales	8,795	8,008
Cost of goods sold	5,534	4,809
Gross margin on product sales	\$ 3,261	\$ 3,199
Gross margin percentage	37%	40%

Product sales for the year ended December 31, 2009 were \$8.8 million, compared with \$8.0 million for the year ended December 31, 2008, an increase of 10%. Sales of Pennsaid products were the most significant accounting for 90% of total product sales for the year ended December 31, 2009 versus 87% for the comparative period.

Pennsaid sales

Sales of Pennsaid increased 14% to \$8.0 million for the year ended December 31, 2009 compared to \$7.0 million for the year ended December 31, 2008. The increase in product sales is primarily related to:

- a \$0.5 million increase in sales to our Canadian licensee, Paladin, to \$1.9 million; and,
- a \$0.6 million increase in sales to our Greek licensee, Vianex, to \$5.0 million.

During 2009, Vianex substantially completed their switch to marketing Pennsaid exclusively in a 60ml format versus a combination of the 60ml format and the 30ml format in previous years. Although this resulted in lower revenue per milliliter of product sold by the Company in 2009, the increase in total sales volume of 15% and the stronger Euro more than offset the impact. Pennsaid has now been the market leader by revenue in Greece's topical anti-rheumatics market for two years with a market share exceeding 30% based on published industry data even though three generics now compete against it. Sales in other European countries were unchanged at \$1.1 million.

Geographically in 2009, sales in Europe increased 10% to \$6.1 million or 76% of total Pennsaid product sales. The increase in European sales is primarily attributable to the higher sales of Pennsaid in Greece. In Canada, sales increased by 34% to \$1.9 million. Canadian sales represented 24% of Pennsaid's product sales in 2009 versus 20% in 2008.

WF10 sales

Sales of WF10 based products for the year ended December 31, 2009 decreased to \$775,000 compared to \$962,000 for the year ended December 31, 2008. The decrease for the year is attributable to lower sales to the Company's distributors in Pakistan, Thailand and Indonesia, partially offset by a 5% increase in sales to the Company's distributor in Venezuela.

Oxoferin™, a wound healing drug derived from WF10, is currently sold in Germany under the trade name "Oxovasin®". Oxoferin™ is also authorized for sale and marketed in India, Indonesia, Pakistan, Thailand and Venezuela. The Company sells the product in these markets in two forms

depending on the terms of the specific marketing arrangement. In some of these markets, the Company sells Oxoferin™ prepackaged to local distributors and in the others the raw material, OXO-K993, is sold to the distributor who manufactures Oxoferin™ for the local market. The Company has signed new licensing agreements covering 21 countries in Europe and Asia, including Russia in the past two years; however, no product sales have been generated through these arrangements as the licensees are still in the process of seeking marketing approvals.

Contract manufacturing sales

Contract manufacturing sales for the year ended December 31, 2009 were \$62,000 compared to \$90,000 for the year ended December 31, 2008. Sales declined as the Company did not accept any new contract manufacturing jobs during the second and third quarters while the Varennes manufacturing facility focused on expanding its capacity in anticipation of a U.S. launch. While not core to the facility's business, contract manufacturing has provided additional revenue and absorbed excess manufacturing capacity and cost without affecting the Company's ability to supply Pennsaid worldwide.

Significant customers

As the Company sells product in a limited number of markets through exclusive agreements, it receives most of its revenue from a limited number of customers. Product sales to the Company's three largest customers are illustrated in the following table:

(in thousands, except percentages)	Year ended December 31, 2009	Year ended December 31, 2008
Three Largest Customers	\$ 7,673	\$ 6,659
% of Total Product Sales	87%	83%
Largest Customer as % of Total Product Sales	57%	55%

Gross margin

In the year ended December 31, 2009, gross margin on product sales increased to \$3.3 million compared to \$3.2 million for the year ended December 31, 2008. The increase in gross margin is entirely attributable to the additional margin on the 14% increase in Pennsaid sales. The additional volume allowed the Company to better utilize capacity at its Canadian manufacturing facility. Offsetting most of the improvement was higher costs for many of the raw materials used to compound and package Pennsaid including the negative impact of an 8% stronger U.S. dollar for the year versus 2008 on materials sourced from or priced in U.S. dollars. Under the terms of many of its supply agreements, the Company is not able to pass cost increases on to customers as they occur, if at all. Also offsetting the impact of the higher Pennsaid sales was the impact of the 19% decrease in WF10 based product sales and the costs related to the eight week Varennes production shutdown during the second quarter, as they initiated work to expand capacity.

The overall gross margin percentage was 37% for the year ended December 31, 2009 versus 40% for the same period in 2008. The year-over-year decline of 3% was caused by increased Pennsaid raw material costs related to the stronger U.S. dollar, the lost contribution from lower WF10 product sales, the change in format in Greece and the Varennes shut-down, offset only somewhat by the higher Pennsaid sales.

License Fees

During the year ended December 31, 2009, the Company recorded \$29.6 million in licensing fee revenue compared to \$2.5 million for the year ended December 31, 2008. The significant

increase in the year relates to amounts earned from the U.S. Licensing Agreement which is discussed under the section entitled “Significant Transactions – 2009 – Pennsaid U.S. Licensing Agreement and FDA Approval”. In 2009, under the terms of this agreement, the Company received the Initial Payment and the FDA Approval Payment totaling \$27.3 million in aggregate. The balance of licensing fee revenue of \$2.2 million in 2009 represents the recognition of a portion of the upfront fees received from Paladin in 2005 and 2006 for the Canadian marketing rights for Pennsaid versus \$1.6 million in 2008. Licensing fees in 2008 also include \$0.9 million received by the Company upon the consummation of the New Canadian Licensing Arrangements to settle obligations under the original licensing arrangements incurred prior to July 7, 2008 as discussed under the section entitled “Significant Transactions – 2008 – New Canadian Licensing Arrangements”.

Research and Other Contract Revenue

Research and other contract revenue for the year ended December 31, 2009 was \$299,000 compared with \$205,000 for the year ended December 31, 2008. This revenue was generated by the Company’s San Diego based research and development facility and increased as a result of the work it completed in 2009 with a Fortune Global 500 Company under a collaboration agreement signed in 2008.

Operating Expenses

in thousands

	Year ended December 31, 2009	Year ended December 31, 2008
Research and development	\$ 8,575	\$ 9,263
Selling, general and administrative	6,950	5,204
Stock-based compensation	598	803
Amortization of property, plant and equipment and intangibles and impairment of intangibles	547	1,068
Interest, net	736	786
	17,406	17,124
Foreign currency loss (gain)	689	(93)
Total operating expenses	\$18,095	\$17,031

Total operating expenses, excluding foreign currency losses, for the year ended December 31, 2009 were \$17.4 million, a two percent increase from \$17.1 million for the year ended December 31, 2008.

Research and Development

Research and development expenses were \$8.6 million for the year ended December 31, 2009 a decrease of 7% compared with \$9.3 million for the year ended December 31, 2008. The decrease for the year relates to reduced spending on Pennsaid for two reasons: all significant studies necessary for filing the Company’s Complete Response to the Pennsaid Approvable Letter were completed prior to filing the Pennsaid NDA in early 2009; and, under the terms of the U.S. Licensing Agreement, Covidien assumed responsibility for all Pennsaid and Pennsaid Plus development activities and costs subsequent to the Effective Date. As a result, the Company’s spending on Pennsaid and Pennsaid Plus declined by \$2.4 million. These declines were partially offset by a \$0.7 million increase in costs related to research and formulation development activities at the Company’s research labs in San Diego and \$0.9 million of severance costs.

The balance of the research and development spending for 2009 included:

- The ongoing costs associated with the Company's laboratory in Varennes, Québec and its clinical, preclinical and regulatory groups in Mississauga and Pennsylvania;
- External work in the areas of chemistry, manufacturing and controls ("CMC"), intellectual property and preclinical work on early stage pain and dermatologic drug candidates; and,
- Costs related to the conduct, termination and analysis of interim results of the Phase 2 clinical trial using WF10 as an adjuvant treatment for inoperable pancreatic cancer and preparation for the planned proof of concept study assessing WF10 as a treatment for allergic rhinitis.

Research and development expenditures vary depending upon the stage of development of drug products and candidates in the Company's pipeline and management's allocation of the Company's limited resources to these activities in general and to each drug specifically. In 2009, the Company limited external spending on its early stage pipeline for most of the year as it conserved its cash resources prior to FDA approval and signing a U.S. licensee for Pennsaid. For 2010, the Company plans to increase both its internal and external research and development spending as it focuses on expanding and developing its early stage drug candidate pipeline and runs the WF10 allergic rhinitis trial in Germany.

Selling, General and Administrative ("SG&A")

SG&A expenses increased to \$7.0 million for the year ended December 31, 2009, compared to \$5.2 million for the year ended December 31, 2008.

During the year, the \$1.8 million or 34% increase in SG&A expense is primarily attributable to increased compensation expense of \$1.4 million, higher legal fees and royalties payable to Paladin. Compensation increased as certain senior executives who had not received cash bonuses in prior years were awarded bonuses on account of 2009 and prior years subsequent to signing the U.S. Licensing Agreement such that compensation expense for 2009 includes approximately 27 months of senior management bonuses, \$1.0 million, compared to \$nil in 2008 and an increase in director's fees of \$0.2 million primarily related to the revaluation of the outstanding DSUs to their market value at year end as the Nuvo share price appreciated substantially during 2009. Legal fees increased by \$0.2 million and related primarily to U.S. licensing negotiations and the Company paid royalties of \$0.1 million to Paladin as their 0.5% share of the Initial Payment and the FDA Approval Payment under the terms of the New Canadian Licensing Arrangements.

Stock-Based Compensation

Total compensation expense related to shares issued and options granted under the Company's Amended and Restated Share Incentive Plan (the "Share Incentive Plan") for the year ended December 31, 2009 decreased to \$598,000 compared to \$803,000 for the 2008. Stock-based compensation expense recognized under each of the Share Incentive Plans three sub plans, the Employee Share Purchase Plan, the Share Option Plan and the Share Bonus Plan all decreased compared to the year ended December 31, 2008.

Under the employee share purchase plan, eligible employees may contribute up to 10% of their annual base salary for the purchase of Nuvo common shares. The Company matches each participant's contribution by issuing Nuvo common shares having a value equal to the amount contributed by each participating employee. During 2009, the compensation expense recognized

under this plan decreased by \$49,000 as participation declined compared to the prior year. During 2009, the Company matched employee contributions by issuing 338,001 [2008 - 1,565,926] common shares and recording compensation expense equal to their fair value of \$120,000 [December 31, 2008 - \$169,000].

Compensation expense related to the stock option plan decreased in 2009 to \$478,000 from \$616,000 in 2008. Generally upon issuance of a Company stock option to an employee, one-third of the compensation expense attributable to the option is recognized, as one-third vests immediately, and upon issuance of options to directors, which vest immediately, all compensation expense attributable to the option is recognized. In 2008, 3.2 million stock options were granted to employees and 0.7 million to directors resulting in \$92,000 of compensation expense recognized upon the grant date. In 2009, only 0.5 million stock options were granted to employees and none to directors resulting in \$28,000 of compensation expense recognized upon the grant date. No options were granted to the directors in 2009, as the non-cash portion of their 2009 compensation was satisfied through the issuance of DSUs under the newly established DSU Plan. Also, during the fourth quarter of 2009, the compensation expense attributable to a significant number of options issued in prior years became fully amortized such that lower compensation expense was recorded in this period.

Compensation expense for the share bonus plan was \$nil for the year ended December 31, 2009 compared to \$18,000 for the year ended December 31, 2008. In 2008, the amount included bonus payments to employees and the payment of advisory fees to a member of the Company's Scientific Advisory Board in lieu of cash compensation.

Amortization of Property, Plant and Equipment and Impairment of Intangibles

Amortization charges for the year ended December 31, 2009 were \$547,000 compared to amortization and impairment charges of \$1,068,000 for the year ended December 31, 2008.

Amortization charges for the year ended December 31, 2009 were \$547,000 compared to \$870,000. The decrease relates primarily to assets acquired upon the 2005 purchase of the Company's research and development centre in San Diego that became fully amortized at the end 2008.

In 2008, the Company recorded an impairment charge of \$198,000 relating to its patents after conducting a review of its portfolio of potential drug candidates. This review resulted in changes to the Company's drug development strategy that included, among other things, revised development timelines for certain drug candidates, reprioritizing the importance of specific drug candidates for development and identifying new drug candidates. Subsequent to this review, the Company assessed the impact of these drug development strategy changes on the recoverability of the carrying values of each of its intangible assets. Based on its assessment, it was determined that the carrying value of certain patents would not be recoverable and, therefore, an impairment charge was recorded to income.

Interest

Interest expense was \$0.8 million for the year ended December 31, 2009 compared to \$1.3 million for the year ended December 31, 2008. The decrease in the year is attributable to \$0.4 million of lower non-cash accretion charges and cash interest payments on the convertible debentures due to conversions and the elimination of interest expense on the short-term loan.

Interest income decreased to \$79,000 for the year ended December 31, 2009 compared to \$497,000 for the year ended December 31, 2008. The decrease in interest income was caused entirely by historically low rates of interest earned on the Company's cash and cash equivalents as its cash balances have been significantly higher than a year ago. Interest rates received on cash and cash equivalents continued to be well below 0.5% and the Company expects rates to remain below 1% in the near-term given the current economic climate and the Company's desire to preserve capital rather than maximize return through additional risk.

The aggregate result was a decrease in net interest expense to \$736,000 for the year ended December 31, 2009 compared to \$786,000 for the year ended December 31, 2008.

Foreign Currency Losses

The Company realized net foreign currency losses of \$689,000 for the year ended December 31, 2009 compared to net foreign currency gains of \$93,000 for the year ended December 31, 2008. The negative impact of the weakening U.S. dollar and Euro over the past six months on the Company's Euro denominated accounts receivable, Euro and U.S. denominated cash and cash equivalent balances and the translation of the Company's net investment in its foreign subsidiaries was only minimally offset by the positive impact it had on the Company's Euro and U.S. denominated accounts payable.

Income (loss) from Operations

Income from operations was \$15.0 million for the year ended December 31, 2009 compared to a loss of \$11.1 million for the year ended December 31, 2008 an improvement of \$26.1 million. The improvement in 2009 can be substantially attributed to \$27.3 million in revenue derived from the U.S. Licensing Agreement.

On a segmented basis, Pain, which utilizes the TTDD platform and includes all Pennsaid activities, earned income of \$15.1 million in 2009 and Immunology, which utilizes the ISR platform and includes all WF10 activities, incurred a small loss of \$81,000. In the year ended December 31, 2008, Pain and Immunology incurred losses of \$10.4 million and \$703,000, respectively. The revenue from the U.S. Licensing Agreement is included in the Pain segment and is the reason for their substantial improvement in 2009. The losses incurred by Immunology are small relative to Pain, as the level of research and development activity conducted over the past two years has been confined to the pancreatic cancer trial and other small projects that were funded primarily through the cash flow generated from sales of Oxoferin™. The Company expects losses from Immunology to increase from current levels in future periods as it ramps up WF10 research and development activities at Nuvo Research GmbH in collaboration with the Fraunhofer Institute for the treatment of allergic rhinitis and rheumatoid arthritis. A portion of this spending will be reimbursed under an agreement with the SAB.

OTHER INCOME

in thousands

	Year ended December 31, 2009	Year ended December 31, 2008
Loss on extinguishment of convertible debentures	\$ -	\$ (299)
Change in estimate of contingency	-	860
Other income	\$ -	\$ 561

Loss on Extinguishment of Convertible Debentures

On September 18, 2008 (the "Amendment Date"), the Company amended the terms of the November 2004 Unsecured Convertible Debentures, pursuant to a written resolution whereby the November 2004 Unsecured Convertible Debenture Holders agreed to amend certain terms of the November 2004 Unsecured Convertible Debentures. The terms were amended to extend the maturity date by one year from November 16, 2009 to November 16, 2010 and to adjust the conversion price of all November 2004 Unsecured Convertible Debentures to \$0.138, the five day volume-weighted average trading price of Nuvo common shares as of August 1, 2008, the date the offer to the debenture holders was announced. These debentures, which had a total principal amount outstanding of \$4.1 million at the time, were originally convertible into Nuvo common shares at a conversion price of \$0.30 per share except for certain debentures held by directors and officers of Nuvo, which were convertible at a price of \$0.39 per share.

The amendments to the November 2004 Unsecured Convertible Debentures resulted in a significant change to their future cash flows and as a consequence the transaction was accounted for as an extinguishment of the then outstanding November 2004 Unsecured Convertible Debentures ("Old Debentures") and an issuance of new November 2004 Unsecured Convertible Debentures under the amended terms ("New Debentures"). The carrying value of the Old Debentures was \$2.7 million on the Amendment Date and the Company determined the fair value of the debt component of the New Debentures to be \$3.0 million using a discount rate of 25%. The difference between the carrying value of the Old Debentures and the fair value of the New Debentures of \$299,000 was recorded as a loss on extinguishment in 2008.

Change in Estimate in Contingency

As described in the section entitled "Litigation – Leadenhall", in 2003, the Company received a loan from Leadenhall Bank and Trust Company (the "Mortgagee"). The balance owing under this loan is in dispute and is the subject of legal actions between the Company and the Mortgagee's court appointed liquidator. The short-term loan, previously recorded as a current liability on the Company's balance sheet, represented the amount subject to the Ontario Action which was dismissed for delay on August 30, 2007. Given the Liquidator had taken no subsequent action with respect to the dismissal and the passage of time since the dismissal, management believed that it was very unlikely that the Company faced any ongoing exposure to successful claims in Ontario in regards to this matter. As a result, the Company reversed the \$860,000 short-term loan which consisted entirely of the disputed interest with a credit to income in 2008.

Net Income (loss) and Total Comprehensive Income (loss)

Net income and total comprehensive income was \$15.0 million for the year ended December 31, 2009 compared to a net loss and total comprehensive loss of \$10.6 million for the year ended December 31, 2008. For 2009, the net income was the same as the income from operations, whereas in 2008 the net loss was lower than the loss from operations due to the \$0.9 million gain on the change in estimate of the contingency partially offset by the \$0.3 million loss incurred on the extinguishment of the convertible debentures.

Net Income (loss) per Common Share

Net income per common share on both a basic and diluted basis was \$0.04 for the year ended December 31, 2009 versus a net loss per common share of \$0.03 for the year ended December 31, 2008.

The weighted average number of common shares outstanding on a basic and diluted basis was 363.4 million and 400.2 million, respectively for the year ended December 31, 2009 versus 306.3

million on both a basic and diluted basis for the year ended December 31, 2008. The majority of the increase in the basic number of shares outstanding in 2009 is attributable to the 58.7 million common shares issued upon the conversion of warrants during the year and the 18.1 million common shares issued upon the conversion of convertible debentures during 2009.

Liquidity and Capital Resources

in thousands

	Year ended December 31, 2009	Year ended December 31, 2008
Net income (loss)	\$ 15,018	\$(10,552)
Items not involving current cash flows	80	153
Cash provided by (used in) operations	15,098	(10,399)
Net change in non-cash working capital	1,161	270
Deferred proceeds from licensing arrangements	-	1,014
Cash provided by (used in) operating activities	16,259	(9,115)
Cash used in investing activities	(391)	(123)
Cash provided by financing activities	11,461	2,409
	27,329	(6,829)
Effect of exchange rates on cash and cash equivalents	(446)	257
Net increase (decrease) in cash and cash equivalents	26,883	(6,572)
Cash and cash equivalents, beginning of year	15,219	21,791
Cash and cash equivalents, end of year	\$ 42,102	\$ 15,219

Cash and Cash Equivalents

Cash and cash equivalents were \$42.1 million as at December 31, 2009, a \$26.9 million increase compared to \$15.2 million as at December 31, 2008, primarily as a result of the \$15.1 million of net income for the year and the \$11.6 million in proceeds received upon the exercise of warrants.

Operating Activities

Cash provided by operations was \$15.1 million for the year ended December 31, 2009 compared to cash used in operations of \$10.4 million for the year ended December 31, 2008, an improvement of \$25.5 million. The increase is entirely attribute to the swing from a net loss of \$10.6 million to net income of \$15.0 million in 2009 as non-cash items were the same in each year.

Overall cash provided by operating activities was \$16.3 million for the year ended December 31, 2009 versus cash used in operating activities of \$9.1 million for the year ended December 31, 2008 for the reason outlined in the preceding paragraph. The amounts are higher than the cash provided by operations due to the recovery of non-cash working capital in both years and \$1.0 million of deferred proceeds from the New Canadian Licensing Arrangements in 2008.

In 2009, the recovery of the Company's investment in non-cash working capital in the amount of \$1.2 million was achieved primarily due to a higher level of accruals at December 31, 2009 for bonuses and severance partially offset by higher levels of inventory to support the U.S. launch of Pennsaid. In 2008, the recovery of the Company's investment in non-cash working capital in the amount of \$0.3 million was achieved despite the increased level of receivables and inventory to support growth as the Company collected a \$579,000 receivable from Paladin as part of the

“Amended and Restated Canadian Licensing Arrangements” and received its OITCs tax refunds for the years ending December 31, 2005 and 2006 after completion of a government audit.

Investing Activities

Net cash used in investing activities totaled \$391,000 for the year ended December 31, 2009 compared to \$123,000 in the year ended December 31, 2008. In 2009, capital expenditures relate primarily to the purchase of new production equipment to expand capacity at the Company’s Québec manufacturing facility in preparation for the anticipated U.S. launch of Pennsaid and new lab equipment for the Company’s research centre in San Diego. In 2008, the Company invested in the installation and set up of a new data management and biostatistics computer system, new IT equipment as the Company upgraded its network and related infrastructure at each of its North American locations, new lab equipment for the manufacturing facility in Varennes and expansion of the Company’s research centre in San Diego.

Financing Activities

Net cash provided by financing activities totaled \$11.5 million for the year ended December 31, 2009 compared to \$2.4 million for the year ended December 31, 2008. During 2009, all cash provided by financing activities was attributable to the following:

- \$7.9 million upon the exercise of 28.0 million warrants subsequent to the end of the Warrant Incentive Program under their original terms;
- \$3.7 million under the 2009 Warrant Incentive Program upon the exercise of 30.7 million warrants. This program was designed to encourage the early exercise of June 2006 Warrants, July 2007 Warrants and November 2004 Warrants. In order to encourage the early exercise of the these warrants, Nuvo amended the terms of such warrants so that upon payment of a reduced exercise price of \$0.125 and surrender of the holder’s warrant certificate, in accordance with applicable procedures, the holder was entitled to receive one common share of the Company. The exercise period commenced on January 21, 2009 and ended on April 3, 2009;
- \$0.1 million in employee contributions under the Share Purchase Plan; offset by,
- \$0.2 million in regularly scheduled debt repayments and capital lease payments.

In 2008, \$2.4 million was provided from the following activities:

- \$2.0 million of net proceeds from the Paladin Debenture;
- \$0.9 million of net proceeds from the May 29, 2008 private placement equity financing (the “May 2008 Financing”) with Paladin. At closing, a total of 7,692,307 shares were issued to Paladin at a price of \$0.13 per share for gross proceeds of \$1 million. In addition, the Company issued 769,230 common share purchase warrants of the Company, each whole warrant entitling Paladin to acquire one common share at a price of \$0.169 per share until May 29, 2010. Once expenses associated with the financing were deducted, net cash proceeds were \$0.9 million; and,
- \$0.2 million in employee contributions under the Share Purchase Plan; offset by,
- \$0.1 million in regularly scheduled debt repayments and capital lease payments; and,
- repayment of a \$500,000 convertible debenture issued to Paladin. The maturity date was December 22, 2009 provided that if the Company had not commenced a pivotal Phase 3 clinical trial for Pennsaid Plus on or prior to May 21, 2008 (the “Milestone”), then, at Paladin’s option by Notice to the Company, the maturity date shall be May 21, 2008. The

Company did not achieve the Milestone and Paladin demanded repayment, whereupon the Company repaid the debenture.

During 2009, the entire \$2.0 million Paladin Debenture and \$0.5 million in face value of the November 2004 Unsecured Convertible Debentures were converted into 18.1 million shares of the Company. In 2008, \$150,000 in face value of the November 2004 Unsecured Convertible Debentures was converted into 1.1 million shares of the Company.

Selected Quarterly Information (unaudited)

The following is selected quarterly financial information for the last eight quarterly reporting periods:

(in thousands, except per share data)

	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009
Revenue	\$ 3,047	\$2,706	\$3,234	\$29,660 ⁽¹⁾
Net income (loss)	(2,868)	(1,664) ⁽²⁾	(2,725)	22,275 ⁽¹⁾
Income (loss) per share				
basic	\$(0.01)	\$(0.01)	\$(0.01)	\$ 0.06
diluted	\$(0.01)	\$(0.01)	\$(0.01)	\$ 0.05
	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008
Revenue	\$ 2,236	\$2,085	\$ 3,289 ⁽⁴⁾	\$ 3,117
Net loss	(2,271)	(2,864)	(3,004) ⁽⁵⁾	(2,413) ⁽³⁾
Loss per share –				
basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$(0.01)

(1) The quarter ended December 31, 2009 includes \$27.3 million in licensing fees from the U.S. Licensing Agreement representing the Initial Payment and the FDA Approval Payment and \$0.6 million in costs for royalty and milestone payments directly related to the approval.

(2) The quarter ended June 30, 2009 includes a \$0.9 million reimbursement of research and development costs incurred prior to the Effective Date from the U.S. Licensing Agreement.

(3) The quarter ended December 31, 2008 includes a \$0.9 million gain on the change in estimate in the Leadenhall contingency.

(4) The quarter ended September 30, 2008 includes \$0.9 million in licensing revenue recognized upon the completion of the Amended and Restated Canadian Licensing Arrangements with Paladin.

(5) The quarter ended September 30, 2008 includes a \$0.3 million loss on the extinguishment of a convertible debenture.

Fourth Quarter 2009 Results

	Three months ended December 31, 2009	Three months ended December 31, 2008
Product sales	\$ 1,770	\$ 2,430
Cost of goods sold	1,396	1,443
Gross margin on product sales	374	987
License fees	27,873	561
Research and other contract revenue	17	126
	28,264	1,674
Research and development	2,989	2,470
Selling, general and administrative expenses	2,158	1,640
Stock-based compensation	203	306
Amortization of property, plant and equipment and intangibles and impairment of intangibles	97	435
Foreign currency (gain) loss	383	(105)
Interest expense, net	159	201
Operating expenses	5,989	4,947
Income (loss) from operations	22,275	(3,273)
Other income	-	860
Net Income (loss)	\$ 22,275	\$(2,413)

Key Developments

- On November 4, 2009, the FDA approved the NDA for Pennsaid permitting it to be sold and marketed in the United States;
- Received the \$16.0 million (US\$15.0 million) FDA Approval Payment from Covidien under the terms of the U.S. Licensing Agreement; and,
- Entered into an exclusive license agreement with Ranbaxy for the supply and distribution of Oxoferin™ in Singapore, Malaysia, Philippines, Vietnam and other Indochina countries.

Pennsaid FDA Approval

On November 4, 2009, the FDA approved the NDA for Pennsaid permitting it to be sold and marketed in the United States. This approval significantly impacts the Company's fourth quarter results. The quarterly revenue includes \$27.3 million in licensing fee revenue comprised of the \$11.3 million (US\$10 million) Initial Payment earned under the U.S. Licensing Agreement with Covidien and \$16.0 million (US\$15.0 million) FDA Approval Payment under the same agreement. In addition, the Company incurred \$0.6 million of costs directly related to the approval including: \$0.1 million, representing a 0.5% royalty payable to Paladin under the terms of New Canadian Licensing Arrangements (see Significant Transactions – 2008 - New Canadian Licensing Arrangements); and a \$0.5 million milestone payment related to proprietary research. The net impact of these approval related items is an increase to net income of \$26.7 million.

Operating Results

Total revenue for the three months ended December 31, 2009 was \$29.7 million compared to \$3.1 million for the three months ended December 31, 2008 an increase of \$26.6 million. The increase is primarily attributable to the \$27.3 million related to the U.S. Licensing Agreement as discussed in the previous paragraph offset by a \$0.6 million reduction in product sales and a \$0.1 million reduction in research and other contract revenue. This decrease in product sales was primarily attributable to lower sales of Pennsaid to Greece versus the comparable quarter in 2008. The fourth quarter of 2008 was, and still represents, the highest quarterly sales to Vianex by the Company.

In the fourth quarter of 2009, gross margin on product sales declined by \$0.6 million to \$0.4 million compared to \$1.0 million for the comparable quarter in 2008. The decrease in gross margin is primarily attributable to the 23% decrease in Pennsaid sales and the 70% decrease in sales of WF10 based products and the impact of higher raw material prices versus a year ago.

Total operating expenses for the three months ended December 31, 2009 increased to \$6.0 million versus \$4.9 million for the three months ended December 31, 2008. The \$1.1 million increase in operating expenses is primarily due to the \$0.6 million in FDA approval related costs, as discussed above in the section "Pennsaid FDA Approval", severance and a foreign exchange loss, offset somewhat by the absence of an impairment charge in 2009 and lower stock-based compensation expenses.

Included in operating expenses are research and development costs which were \$3.0 million for the three months ended December 31, 2009 compared to \$2.5 million for the three months ended December 31, 2008. The increase in the quarter relates to the \$0.5 million the milestone payment and severance, while other R&D spending was lower as the fourth quarter of 2008 included \$1.2 million in expenses related to completing studies for the Company's Complete Response to the Pennsaid Approvable Letter.

SG&A increased to \$2.2 million for the three months ended December 31, 2009 compared to \$1.6 million for the three months ended December 31, 2008. The increase in the quarter relates to higher compensation expense, the royalty payment and severance. In 2008, the Company incurred higher professional and consulting fees as it was preparing for licensing discussions in the United States.

Income from operations for the three months ended December 31, 2009 was \$22.3 million versus a loss from operations of \$3.3 million for the three months ended December 31, 2008. The improvement of \$25.6 million is primarily related to the net impact of the Pennsaid FDA Approval related items, offset somewhat by severance costs.

For the three months ended December 31, 2009, net income increased to \$22.3 million from a net loss of \$2.4 million for the three months ended December 31, 2008. In 2008, the net loss for the quarter includes a non-cash gain of \$0.9 million on the reversal of the short-term loan consisting entirely of disputed interest relating to Leadenhall.

Liquidity

	Three months ended December 31, 2009	Three months ended December 31, 2008
Net income (loss)	\$ 22,275	\$ (2,413)
Items not involving current cash flows	(11,553)	(960)
Cash provided by (used in) operations	10,722	(3,373)
Net change in non-cash working capital	2,159	(788)
Cash provided by (used in) operating activities	12,881	(4,161)
Cash used in investing activities	(58)	(31)
Cash provided by financing activities	16	139
	12,839	(4,053)
Effect of exchange rates on cash and cash equivalents	(226)	370
Net increase (decrease) in cash and cash equivalents	12,613	(3,683)
Cash and cash equivalents, beginning of period	29,489	18,902
Cash and cash equivalents, end of year	\$ 42,102	\$ 15,219

Cash and cash equivalents on hand at December 31, 2009 of \$42.1 million were \$12.6 million more than the \$29.5 million at September 30, 2009. The increase is almost entirely attributable to cash received for the FDA Approval Payment partially offset by other net spending during the quarter.

Cash provided by operating activities of \$12.9 million was significantly higher than the cash used in operating activities of \$4.2 million for the three-month period ended December 31, 2008 due to receipt of the FDA Approval Payment and a recovery of the Company's investment in non-cash working capital due primarily to lower accounts receivable and an increase in accounts payable and bonus and severance accruals. For the three months ended December 31, 2008, the \$0.8 million investment in non-cash working capital relates primarily to a significant increase in accounts receivable attributable to achieving the highest level of quarterly Pennsaid sales to Europe.

Net cash used in investing activities totaled \$58,000 for the quarter ended December 31, 2009 compared to \$31,000 in the quarter ended December 31, 2008. In the 2009 quarter, capital expenditures relate primarily to warehouse equipment and facility upgrades to at the Company's Québec manufacturing facility in preparation for the anticipated U.S. launch of Pennsaid.

Net cash provided by financing activities totaled \$16,000 for quarter ended December 31, 2009, compared to \$139,000 for the quarter ended December 31, 2008. During the fourth quarter of 2009, \$120,000 in employee contributions under the Share Purchase Plan were partially offset by regularly scheduled capital lease payments. In addition in the fourth quarter, the Company repaid the remaining balance of the mortgage in the amount of €92,000 on its European facility by applying the related cash collateral, classified on our balance sheet as restricted cash.

Financial Instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. However, considerable judgment is required to develop these estimates. Accordingly, these estimated values are not necessarily indicative of the amounts the Company could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of each class of financial instruments are discussed below.

The fair values of short-term financial assets and liabilities, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities as presented in the consolidated balance sheets approximate their carrying amounts due to the short period to maturity of these financial instruments.

Rates currently available to the Company for long-term debt, with similar terms and remaining maturities have been used to estimate the fair value of the debentures and capital lease obligations. These fair values approximate the carrying values for all instruments.

FINANCIAL RISK MANAGEMENT

Risk factors

The following is a discussion of market, credit and liquidity risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

Credit risk

The Company's cash and cash equivalents subject the Company to a significant concentration of credit risk. At December 31, 2009, the Company had \$41.4 million invested with a single financial institution in various bank accounts as per its practice of protecting its capital rather than maximizing investment yield through additional risk. The financial institution is a major Canadian bank which the Company believes lessens the degree of credit risk. The remaining cash and cash equivalent balances are held in bank accounts and money market funds in various geographic regions.

The Company, in the normal course of business, is exposed to credit risk from its global customers most of whom are in the pharmaceutical industry. The accounts receivable are subject to normal industry risks in each geographic region in which the Company operates. In addition, the Company is exposed to credit related losses on sales to its customers outside North America and the European Union due to potentially higher risks of enforceability and collectability. The Company attempts to manage these risks prior to the signing of distribution or licensing agreements by dealing with creditworthy customers; however, due to the limited number of potential customers in each market this is not always possible. In addition, a customer's creditworthiness may change subsequent to becoming a licensee or distributor and the terms and conditions in the agreement may prevent the Company from seeking new licensees or distributors in these territories during the term of the agreement. At December 31, 2009, the Company's four largest customers located in North America and Europe represent 84% [2008 - 83%] of accounts receivable and accounts receivable from customers located outside of North America and the European Union represent 5% [2008 - 13%] of accounts receivable.

Pursuant to their collective terms, accounts receivable are aged as follows at December 31, 2009:

(in thousands)	\$
Current	1,870
0-30 days past due	83
31-60 days past due	5
61-90 days past due	-
Over 90 days past due	133
	<u>2,091</u>

As at February 18, 2010, \$216,000 of the past due amounts had been collected.

Liquidity risk

While the Company has \$42.1 million in cash and cash equivalents at December 31, 2009, it continues to have an ongoing need for substantial capital resources to research and develop, commercialize and manufacture its products and technologies. The Company only has limited participation in Pennsaid sales revenues in those markets where it is currently marketed and in the United States although it is approved and the Company is eligible to receive royalties on net sales at rates consistent with industry standards and potential sales milestones it is not yet marketed. Therefore, the Company is not yet receiving an ongoing revenue stream from the U.S. nor can it be certain that it will receive any significant revenue unless the U.S. launch is successful. Even if the launch is successful, Pennsaid's patents have expired such that its only protection is its three year period of exclusivity granted in November 2009 under the "Hatch-Waxman Act" and C.F.R. 314.108(b)(4). As a result, Pennsaid revenues may not be sufficient to provide the capital required for the Company to be self-sustaining without the need for future financings.

There can be no assurance that the Company will have sufficient capital to fund its ongoing operations, develop or commercialize any further products based on its TTDD or ISR platforms without future financings. There can be no assurance that additional financing will be available on acceptable terms, or at all. If adequate funds are not available or the commercial launch of Pennsaid in the U.S. is not successful, or Pennsaid is genericized in the U.S. after it loses its exclusivity, the Company may have to substantially reduce or eliminate planned expenditures, reduce staff and curtail its drug development programs. If the Company is unable to obtain additional financing when and if required, the Company may be unable to continue operations.

Interest rate risk

All debentures and capital lease obligations are at fixed interest rates.

Currency risk

The Company operates globally, which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the U.S. dollar and Euro, but also transacts in other foreign currencies. The Company currently does not use financial instruments to hedge these risks. The significant balances in foreign currencies as at December 31 are as follows:

(in thousands)	Euros		U.S. Dollars	
	2009 €	2008 €	2009 \$	2008 \$
Cash and cash equivalents	1,667	213	4,846	343
Accounts receivable	1,035	1,117	355	-
Other current assets	7	8	27	31
Restricted cash	-	100	-	-
Accounts payable and accrued liabilities	(239)	(257)	(1,448)	(712)
Long-term debt and capital lease obligations	-	(136)	(133)	(212)
	2,470	1,045	3,647	(550)

Based on the aforementioned net exposure as at December 31, 2009, and assuming that all other variables remain constant, a 10% appreciation or depreciation of the Canadian dollar against the U.S. dollar and Euro would have resulted in decreases (increases) in net income and total comprehensive income as follows:

(in thousands)	Net Income (loss) and Comprehensive income (loss)	
	Appreciates 10%	Depreciates 10%
Canadian Dollar		
Versus U.S. dollar	348	(426)
Versus Euro	338	(413)

The Company manages its foreign currency exposures where practical and cost effective. In terms of the Euro, the Company has three significant exposures: its net investment and net cash flows in its European operations, its Euro denominated cash and cash equivalents and sales of Pennsaid by the Canadian operations to European distributors. In terms of the U.S. dollar, the Company has four significant exposures: its net investment and net cash flows in its U.S. operations, its U.S. dollar denominated cash and cash equivalents, the cost of running trials and other studies at U.S. sites and purchasing raw materials either priced in U.S. dollars or sourced from U.S. suppliers that are needed to produce Pennsaid.

The Company does not actively hedge any of its foreign currency exposures given the relative risk of currency versus other risks the Company faces and the cost of establishing the necessary credit facilities and purchasing hedging instruments. As a result, the Company does not attempt to hedge its net investment in foreign subsidiaries. The Company does not currently hedge the cash flows of its European operations as outflows are managed to closely approximate inflows in these operations. The U.S. operations have net cash outflows and these are funded from the Company's U.S. dollar denominated cash and cash equivalents.

Sales to European distributors are primarily contracted in Euros. The Company receives payments from the distributors in its Euro bank accounts and uses these funds to pay Euro expenditures and to fund European operations as necessary. Periodically, the Company reviews the amount of Euros held and if they are excessive compared to the Company's projected future Euro cash flows, they may be converted into U.S. or Canadian dollars.

In June 2009, the Company signed the U.S. Licensing Agreement. Under the terms of the U.S. Licensing Agreement, the Company has received US\$25 million and has the potential to receive royalties, milestone payments and product sales all payments denominated in U.S. dollars. In the past, the Company has not had any meaningful U.S. dollar inflows. Currently, the Company plans to manage its U.S. inflows in a manner similar to its management of Euro denominated

inflows by regularly reviewing the amount of U.S. dollars held and if excessive compared to the Company's projected future U.S. cash outflows, converting the excess amount in to Canadian dollars or other currencies needed for its operations.

Commodity risk

The Company is exposed to commodity risk related to purchases of key raw materials necessary for the manufacture of its bulk product from a limited number of suppliers around the world. The Company attempts to mitigate this risk by entering into long-term supply contracts at fixed pricing with capped annual increases. DMSO (one of the key ingredients in Pennsaid) is the Company's most significant cost subject to commodity risk. The Company has entered into a supply agreement with a U.S. supplier for its pharmaceutical grade DMSO until October 31, 2012 using the supplier's patented process at a fixed base price with capped annual increases. There is commodity risk for all other ingredients in each of the Company's products including the active pharmaceutical ingredient. The Company attempts to mitigate these risks through the use of multiple suppliers and fixed price contracts, but due to the nature of some of the chemicals required and the regulatory paths to approving new suppliers, this is not always possible.

Contractual Obligations

The following table lists the Company's contractual obligations as at December 31, 2009.

<i>in thousands</i>	Payments due by year end				
	Total	2010	2011	2012	2013 and thereafter
Capital lease obligations	\$ 156	\$ 89	\$ 67	\$ -	\$ -
Debentures	3,486	3,486	-	-	-
Operating leases	654	430	201	20	3
Research and other contracts ⁽ⁱ⁾	314	303	10	1	-
	\$ 4,610	\$ 4,308	\$ 278	\$ 21	\$ 3

(i) Included under the caption "Research and other contracts" are commitments totaling \$232,000 that the Company has made for services that are reimbursable under the terms of the U.S. Licensing Agreement.

Off Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Outstanding Share Data

The number of common shares outstanding as at December 31, 2009 was 392.0 million, an increase of 25% from 314.4 million at December 31, 2008. The increase was due to the issuance of 58.7 million shares upon the exercise of warrants; 18.1 million shares issued upon the conversion of \$2.5 million of convertible debentures; 0.7 million shares issued under the Share Purchase Plan; and, 0.1 million issued upon the exercise of stock options.

As at December 31, 2009, there were 25,260,870 common shares potentially issuable on the conversion of the outstanding debentures and 33,662,301 options outstanding of which 32,395,499 million are vested. The Company no longer has any warrants outstanding. During 2009, 58.7 million warrants were exercised and 23.5 million expired.

Litigation

From time-to-time, during the ordinary course of business, the Company is threatened with, or is named as a defendant in various legal proceedings including lawsuits based upon product liability, personal injury, breach of contract and lost profits or other consequential damage claims.

Leadenhall

The Company's former head office property was subject to a \$2.0 million mortgage (the "Mortgage"). As previously disclosed, the Mortgage balance due is in dispute with the Mortgagee. The Mortgage dispute centres on the calculation and amount of interest owing and was the subject of an Ontario court action (the "Ontario Action") commenced by the Mortgagee in April 2005. The Mortgagee's position is that interest should be calculated at a rate of 2% per month calculated monthly; including interest on late payments; and costs. The Company's position is that the Mortgage is null and void and should be discharged, or alternatively, that the interest payable is limited to 5% per annum pursuant to the provisions of the Interest Act (Canada). The Ontario Action was subsequently dismissed by the courts for delay. Subsequent to the filing by the Mortgagee of its Statement of Claim and the Company of its Statement of Defense and Counterclaim, a liquidator (the "Liquidator") of the Mortgagee was appointed by the courts of the Bahamas, where the Mortgagee is situated.

In November of 2005, the Company negotiated a written agreement (the "Settlement Agreement") with the Liquidator to settle all claims pursuant to the Ontario Action for US\$1.1 million (CDN\$1.2 million) (the "Settlement Amount") payable out of closing funds received on the sale of the Company's former head office. The Settlement Agreement is subject to the approval of the Bahamian court that appointed the Liquidator. The Liquidator agreed to seek court approval as soon as possible after signing the Settlement Agreement. The Liquidator did not seek court approval prior to the completion of the head office sale, and in order to allow the sale to proceed, the Liquidator and the Company entered into an escrow arrangement (the "Escrow Agreement"). Pursuant to the Escrow Agreement the Liquidator agreed that upon payment of US\$1.4 million (CDN\$1.6 million) (the "Escrow Amount") to the Liquidator, to be held in escrow pending court approval of the Settlement Agreement, the Liquidator would deliver a discharge of the Mortgage. It was further agreed that upon approval of the Settlement Agreement by the Bahamian Court the Settlement Amount would be released from escrow and paid to the Liquidator and the balance, US\$303,000 (CDN\$318,000), would be released to the Company (the "Excess Amount"). In January 2006, the Liquidator discharged the mortgage, the Company completed the sale of its head office and it paid the Escrow Amount into escrow with the Liquidator's Bahamian counsel.

Subsequent to receipt of the Escrow Amount, the Liquidator has continually delayed seeking court approval of the Settlement Agreement and has not yet presented it to the Bahamian court for approval. Since April 2006, the Liquidator has indicated that while still intending to present the Settlement Agreement to the court for its consideration, it will not recommend that the court approve it. In addition, in its February 2007 Affidavit the Liquidator indicates that if the Court does not approve the Settlement Agreement, it will request that the Bahamian court order that all escrowed funds, including the Excess Amount be released to it and not to the Company. The Liquidator further states that the full amount in escrow is insufficient to retire the mortgage principal plus interest at the alleged interest rate of 2% per month and that it may pursue the Company for the deficiency. The Company retained legal counsel in the Bahamas to assist it in securing court approval of the Settlement Agreement and to ensure that if the Settlement Agreement is not approved, that the escrow continues in accordance with the terms of the Escrow Agreement.

A hearing in the Bahamian court was held in March 2007. At this hearing, the Liquidator submitted additional arguments to the Bahamian court requesting that all matters, including those that form the basis of the Ontario Action, be decided by the Bahamian court. While this request was not ruled upon, the judge issued an order that the escrow funds continue to be held in escrow for at least 90 days to provide the Company an opportunity to bring an action in the Bahamian courts for the release of the funds based upon the non-ratification of the Settlement Agreement. The judge retired shortly thereafter.

In June 2007, as the Company was not able to bring its action to release the escrow funds to it before the Bahamian courts its Bahamian legal counsel filed a summons in the Leadenhall liquidation proceedings requesting that the Company be granted leave to join the liquidation as an interested party. The Summons was served on the Liquidator in June 2007 and requires that the Company be notified if the Liquidator intends to make application to have the escrow funds released to it. Since June 2007, the shortage of commercial judges available to hear the case and a lack of co-operation by the Liquidator has hindered the Company's Bahamian legal counsel's efforts to obtain a date for a hearing at which a judge could consider the Settlement Agreement. Late in 2008, the Company's Bahamian legal counsel informed the Company that a commercial court judge had been assigned to handle all aspects of the Leadenhall liquidation; however, early in 2009, prior to obtaining a hearing this judge resigned from the Bench and the case has not yet been assigned to another judge.

Given these delays, the Company through its Bahamian legal counsel, reinitiated dialogue with the Liquidator's counsel and presented a proposal aimed at resolving all outstanding matters between the Company and the Liquidator, if acceptable we would jointly approach the courts to seek its approval. The Company did not receive a response to its proposal from the Liquidator's counsel. In November 2009, the Company's Bahamian counsel was notified that the Liquidator had switched legal counsel in this matter. The Company's Bahamian counsel has contacted the Liquidator's new counsel but they have indicated that they are not yet in a position to discuss the matter as they are in the process of developing an understanding of all matters related to the Mortgagee's liquidation.

Paladin Tax Reassessment

On August 16, 2005, the Company sold 100% of the common shares of its subsidiary DHCL (renamed Squire and amalgamated with Paladin on January 1, 2009) to Paladin. Under the terms of the share purchase agreement ("SPA") with Paladin, the Company provided representations and warranties with respect to the status of the Company's tax accounts and its tax assets, which consisted of noncapital losses, investment tax credits and undeducted scientific research and experimental development expenditures. If the amounts represented are incorrect then the Company is required to indemnify Paladin for a portion of its losses.

In July and August 2008, Paladin received notices of reassessment (the "2008 CRA Reassessments") relating to its taxation years ending August 16, 2005 and July 31, 2006 and 2007 ("the Tax Years") from the Canada Revenue Agency ("CRA") containing adjustments related to certain transactions occurring in the tax year ended August 16, 2005 (the "Reassessed Transactions") that impact all of the Tax Years. A certain provincial tax authority also reassessed certain of the Tax Years and other provincial tax authorities could have proposed similar adjustments as a result of the CRA reassessments. The notices of reassessment, if they stand, could cause the Company to breach certain representations and warranties in the SPA.

The Company disagreed with the position taken by the CRA and believed it to be without merit. Paladin contested the reassessments through the CRA appeals process and filed a Notice of Objection with the CRA in October 2008. In January 2010, the CRA responded to the Notice of Objection by issuing reassessments for the Tax Years (“January 2010 Reassessments”) that reversed all of the adjustments made by the CRA relating to the Reassessed Transactions, in essence agreeing with Paladin’s original filing position. The January 2010 Reassessments have been forwarded to the provincial tax authority to begin the process of having the adjustments for the Reassessed Transactions reversed as the province previously agreed in writing to be bound by the CRA’s decision. The Company estimates its remaining potential obligation under the indemnification provisions of the SPA relating to the provincial reassessments is in the range of \$0.8 million to \$1.2 million, including interest and penalties. The SPA also requires the Company to indemnify Paladin for out-of-pocket costs (including attorneys’ and experts’ fees) incurred by Paladin that are caused by the Company’s breach of its representations and warranties contained in the SPA. If a favourable resolution is not achieved on the remaining provincial reassessments, it could have a material adverse impact on the Company’s cash flows.

Paladin is a “Large Corporation” under subsection 225.1(8) of the Income Tax Act and as a result, in September 2008 the CRA took action to collect 50% of the amounts reassessed in the 2008 CRA Reassessments. Paladin suggested that it may have a claim against the Company pursuant to the SPA for a portion of the collected amount. However, on November 17, 2008 the Company and Paladin signed an agreement (the “Letter Agreement”), whereby, the Company agreed to provide security (the “Indemnity Security”) to Paladin for potential indemnity obligations that arise from or relate to the CRA Reassessments and to pay half of Paladin’s ongoing out-of-pocket costs to contest the CRA Reassessments. The Indemnity Security charges the revenue from Pennsaid sales in Europe, a mortgage over Nuvo’s manufacturing facility in Québec, a charge on all manufacturing assets in Québec and all Pennsaid inventory and receivables as well as all intellectual property rights required to manufacture and market Pennsaid in Canada. In exchange, Paladin agreed not to pursue any claims against the Company for reimbursement of any funds that Paladin may have paid or may be required to pay in connection with the CRA Reassessments while their contestation is continuing, except in circumstances where the Company has or is determined to have become insolvent as defined in the Letter Agreement.

Research Capital Company (“RCC”)

On June 7, 2006, the Company received a letter from counsel to RCC asserting that as a result of the bought deal equity financing completed by the Company on June 20, 2006, RCC was entitled to payment of \$1.5 million and such number of common shares equal to 8% of the common shares issuable pursuant to an engagement letter for an offering that was contemplated but did not proceed in September 2005. RCC was not involved in the financing. The letter further stated that if the demanded cash payment and common shares were not received on or before June 12, 2006 then a court action would commence by RCC against the Company. On September 15, 2006, RCC commenced legal proceedings against the Company by filing a Statement of Claim with the Ontario Superior Court of Justice. The Statement of Claim claimed that RCC was entitled to: (i) damages in the amount of \$1.5 million or alternatively damages of \$1.0 million; (ii) 3 million warrants to purchase common shares at a price of \$0.50 and an option to purchase \$5 million of Units of the Company or alternatively to (i) and (ii), \$350,000 and in each case interest and costs. Management of the Company believed that RCC’s claim was without merit. The Company filed a Statement of Defense and Counterclaim in October 2006 and vigorously defended its position. In November 2006, RCC served its reply and defense to the counterclaim, but took no further steps to advance the litigation until December 2007 when the Company received RCC’s unsworn affidavit of documents. The Company assembled its affidavit of

documents which was served upon RCC and filed with the court. In November 2008, the Company and RCC signed a Full and Final Mutual Release and agreed to dismiss the Claim and Counterclaim without costs. Prior to the Minutes of Settlement and the Full and Final Mutual Release being filed by RCC's legal counsel with the Ontario Superior Court the Registrar issued an order dismissing the Claim due to delays in proceeding with it. Legal Counsel for the Company and RCC agreed that the dismissal should be withdrawn and replaced by the Minutes of Settlement and the Full and Final Mutual Release. On April 13, 2009, the Ontario Superior Court issued an order setting aside the Registrar's dismissal and dismissed the Claim and Counterclaim on consent of the parties.

Subsequent Event

On February 4, 2010, the Company announced that it will be redeeming the November 2004 Unsecured Convertible Debentures ("Debentures") for cash on March 12, 2010 ("the Redemption Date"). A redemption amount of \$1,035.75 (the "Redemption Price") will be paid for each \$1,000 of principal amount of Debentures, being an amount equal to the aggregate of i) \$1,020 for each \$1,000 principal amount of Debentures plus ii) all accrued and unpaid interest up to but excluding the Redemption Date.

Holders of the Debentures have the right to convert their Debentures into common shares at any time prior to the close of business on the business day immediately preceding the Redemption Date. Holders converting their Debentures are entitled to receive, in addition to the applicable number of shares, accrued and unpaid interest for the period up to, but excluding, the date of conversion from the day immediately following the latest interest payment date, all in accordance with the trust indenture and supplemental indentures.

Recent Accounting Pronouncements

Harmonizing Of Canadian and International Standards

In February 2008, the Accounting Standards Board ("AcSB") of the CICA confirmed that Canadian GAAP for publically accountable enterprises will be converged with International IFRS effective in the calendar year 2011. The conversion to IFRS will be required, for the Company, for interim and annual financial statements beginning on January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosures.

To comply with Canadian Securities Administrators Staff Notice 52-320, Disclosure of Expected Changes in Accounting Policies Relating to Changeover to IFRS, the Company has presented the following information regarding its changeover plan and progress to date, major identified differences in accounting standards and expected changes to accounting policies to allow investors and others to be informed on how the Company expects to be affected by the changeover to IFRS. This information reflects management's most recent assumptions and expectations; however, changes to IFRS or economic conditions could change these assumptions or expectations.

	Key Activities	Timeline / Progress to Date
Accounting policies and financial reporting	Identify applicable differences between IFRS and current accounting practices	Identification of IFRS differences impacting the Company is substantially complete, pending future IFRS changes released by the IASB.
	Finalize accounting policy choices and assess elective options under IFRS 1	Initial accounting policy choices and applicable elective options under IFRS 1 have been identified, reviewed with third-party experts, discussed and approved by senior management, [and approved by the Audit Committee].
	Benchmark progress with industry peer group	The finance team has communicated with industry peers on IFRS differences and proposed accounting treatments.
	Quantify effects of changeover on opening balance sheet	Initial quantification to be completed in first half of 2010.
	Prepare first financial statements and note disclosures under new standards	Initial drafts of comparative statements to be submitted for review in first half of 2010.
Information technology and data systems	Update consolidation system to allow for parallel reporting	Updates to consolidation system underway. Testing and approval of parallel reporting structure expected in first quarter 2010.
Internal control over financial reporting	Approval of accounting policy choices and initial IFRS 1 elections	Initial accounting policy choices and applicable elective options under IFRS 1 have been reviewed by senior management.
	Design, implement and test controls over IFRS data produced in parallel reporting	Control procedures expected for first quarter 2010, and the CFO/CEO certification process to be updated by fourth quarter 2010.
Disclosure controls and procedures	Review and approval of IFRS disclosures	Review and approval of IFRS disclosures ongoing is part of the current disclosure approval process.
Expertise and training	Technical review of IFRS standards, IFRS 1 elections and policy choices	Senior finance staff has attended external IFRS training sessions, participated in web training sessions, and has received continuous communication from third-parties, including IASB's IFRS website.
	Communication within Finance group of plan progress	Senior finance staff meet quarterly to discuss plan status, IASB updates and planned disclosure.

Major identified differences

The Company has identified various IFRS standards below that differ from current accounting practices and that management expects may have a financial impact on its financial statements upon initial conversion. While the financial impact has not been quantified at this time, the following narrative discussion provides insight into the key elements of the Company's financial statements that are expected to be impacted by the changeover to IFRS.

IFRS 1, First-time Adoption of International Financial Reporting Standards, is the standard that provides guidance for creating the Company's first IFRS financial statements. The standard provides elective options in the opening balance sheet to allow financial information to be produced at a cost that does not exceed the benefits to users, and it provides mandatory exceptions to retrospective application of IFRS in certain circumstances to ensure the benefit of hindsight does not impact the integrity of historical information. At this time, the Company expects to apply the following IFRS 1 elections and exemptions in its opening balance sheet:

- Business combinations – *IFRS 3, Business Combinations*, may be applied retrospectively or prospectively. The Company will elect to prospectively apply the standard such that all business combinations prior to January 1, 2010 will not be restated to comply with IFRS 3. By electing to prospectively apply IFRS 3, the Company is prohibited from applying certain amendments of *IAS 27, Consolidated and Separate Financial Statements*, one of the mandatory exceptions to retrospective application of IFRS noted above. Effective January 1, 2010 under IFRS 3, total comprehensive income attributed to a non-controlling interest is recognized even if such attribution results in a deficit balance in the non-controlling interest.
- Share-based payments – *IFRS 2, Share-based payments*, encourages entities to apply the standard to all equity instruments issued, however under IFRS 1 the Company may elect not to apply IFRS 2 to equity instruments issued prior to November 7, 2002, and to equity instruments issued after November 7, 2002 that were vested prior to the date of transition. The Company will make this election and apply IFRS 2 only to equity instruments that were issued after November 7, 2002 that had not vested prior to January 1, 2010.
- Cumulative translation differences – a first-time adopter may be exempt from complying with the requirements of *IAS 21, Foreign Exchange*, for cumulative translation differences that existed at the date of transition to IFRS. The first-time adopter may deem cumulative translation differences for all foreign operations to be zero at the date of transition to IFRS, and the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRS. The Company will elect to deem its prior cumulative translation adjustments of \$114,000 to be \$nil, and prospectively accumulate translation differences for its foreign operations under IAS 21 as at January 1, 2010.
- Borrowing costs – the Company will elect to apply the transitional provisions *IAS 23, Borrowing Costs*, and capitalize borrowing costs of qualifying assets prospectively from the date of transition to IFRS.

IFRS 2, Share-based payments, will apply to the Company's share options that were granted after November 7, 2002, but have not vested prior to January 1, 2010, as noted above. The Company currently uses a straight-line approach to amortization of share-based compensation

expense. Under IFRS 2, options that vest in installments are amortized accordingly in an accelerated format. In addition, the Company had adjusted for forfeitures as they occurred, whereas IFRS 2 will require an estimate of forfeitures on initial recognition.

IAS 12, Income Taxes, and a proposed exposure draft, *Income Tax*, proposing many changes to IAS 12 have been the subject of significant international debate, such that the proposed changes to the standard as outlined in the exposure draft have recently been put on hold. While the fundamental principles of IAS 12 are similar to Canadian GAAP, the Company plans to obtain third-party assistance in 2010 to assist in determining the proper application of IAS 12.

IAS 21, Foreign Exchange, explicitly requires an entity to first determine its functional currency using explicitly prescribed tests that differ from Canadian GAAP prior to translating its financial results into the reporting currency of the consolidated entity. Under Canadian GAAP, the Company's foreign subsidiaries are considered integrated operations and therefore requires the use of temporal based accounting when translating their financial statements into Canadian dollars, the Company's reporting currency. IAS 21 does not distinguish between integrated foreign operations and self-sustaining foreign operations and requires the financial results of all of the Company's foreign operations to be translated to the Company's reporting currency using an approach commonly known as the current rate method. Under the temporal method of translation only monetary assets and liabilities are translated to the reporting currency at current rates of exchange and the effect of the translation is reported as a foreign exchange gain or loss. Under the current rate method all assets and liabilities are translated to the reporting currency at current rates of exchange and the effect of the translation is reported as other comprehensive income or loss. The transitional impact of changing to the current rate method will be the revaluation of non-monetary assets and liabilities as at January 1, 2010 for inclusion in the opening balance sheet. Subsequent to this date all changes will be recorded as other comprehensive income and their cumulative impact will be included in equity as accumulated other comprehensive income.

IAS 27, Consolidated and Separate Financial Statements, will require non-controlling interests to be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the Company. Total comprehensive income must be attributed to the owners of the Company and to the non-controlling interests based on their proportionate ownership even if such attribution results in a deficit balance in the non-controlling interest. Canadian GAAP does not allow allocation of losses to the non-controlling interest if such attribution puts the minority interest in a deficit position, a debit balance. Pursuant to mandatory exceptions to retrospective application of IFRS in IFRS 1, as discussed above, recognition of the non-controlling interests deficit balance in the Company's non-wholly owned subsidiaries will commence January 1, 2010.

Comparative Figures

Pursuant to *IAS 1, Presentation of Financial Statements*, the Company will be required to group its expenses on the income statement using a classification system based solely on function. The Company currently presents its expenses by function, with the exception of amortization of property, plant and equipment and intangibles and stock-based compensation. The Company's IFRS consolidated statement of profit or loss will allocate amortization and stock-based compensation to the relevant functional areas of cost of goods sold, research and development, and SG&A expenses.

Business Combinations

In January 2009, the CICA issued new *Handbook Section 1582, Business Combinations*. Section 1582 will be converged with *IFRS 3, Business Combinations* and replaces *Handbook Section 1581, Business Combinations*. Section 1582 establishes the standards for the measurement of a business combination and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This section is effective for acquisition dates on or after January 1, 2011. The Company may elect to early adopt this section and if so, will be required to early adopt *Section 1601, Consolidated Financial Statements* and *Section 1602, Non-controlling Interests*.

Consolidated Financial Statements

In January 2009, the CICA issued *Handbook Section 1601, Consolidated Financial Statements*, which replaces *Handbook Section 1600, Consolidated Financial Statements* other than the standards relating to non-controlling interests. The section establishes the standards for preparing consolidated financial statements and is effective for fiscal years beginning on or after January 1, 2011. The Company may elect to early adopt this section and if so, will be required to early adopt *Section 1582, Business Combinations* and *Section 1602, Non-controlling Interests*.

Non-controlling Interests

In January 2009, the CICA issued new *Handbook Section 1602, Non-controlling Interests*, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is effective for fiscal years beginning on or after January 1, 2011. The Company may elect to early adopt this section and if so, will be required to early adopt *Section 1582, Business Combinations* and *Section 1601, Consolidated Financial Statements*.

Multiple Deliverable Revenue Arrangements

In December 2009, the CICA issued EIC 175, *Multiple Deliverable Revenue Arrangements*, replacing EIC 142, *Revenue Arrangements with Multiple Deliverables*. This abstract was amended to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated; (2) require, in situations where a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance.

The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If the Abstract is adopted early, in a reporting period that is not the first reporting period in the entity's fiscal year, it must be applied retroactively from the beginning of the Company's fiscal period of adoption. The Company is currently assessing the future impact of these amendments on its financial statements and has not determined the timing and method of its adoption.

Risk Factors

Prospects for companies in the biotechnology and pharmaceutical industry generally may be regarded as uncertain given the nature of the industry and, accordingly, investments in biotechnology and pharmaceutical companies should be regarded as speculative. Research and development involves a high and significant degree of risk. An investor should carefully consider the risks and uncertainties described below, as well as other information contained in this Management's Discussion and Analysis of Operating Results as well as broader risk factors discussed in the Company's Annual Information Form (AIF). The risks and uncertainties described below are not an exhaustive list. Additional risks and uncertainties not presently known to the Company or that the Company believes to be immaterial may also adversely affect the Company's business. If any one or more of the following risks occur, the Company's business, financial condition and results of operations could be seriously harmed. Further, if the Company fails to meet the expectations of the public market in any given period, the market price of the Company's common shares could decline. Before making an investment decision, each prospective investor should carefully consider the risk factors set out below and those included in the AIF and other public documents.

Need for Additional Financing

The Company has an ongoing need for substantial capital resources to research, develop, commercialize and manufacture its products and technologies. The Company only has limited participation in Pennsaid sales revenues in those markets where it has currently been approved, except for the United States where it will receive royalties on net sales at rates consistent with industry standards and potential sales milestones. However, the product has not yet launched in the United States such that the Company is not receiving any ongoing revenue nor can it be certain that it will receive any significant revenue unless the United States launch is successful. Even if the launch is successful, Pennsaid's patents have expired and its only exclusivity is the three-year period of exclusivity granted under the "Hatch-Waxman Act" and C.F.R. 314.108(b)(4) because the NDA was filed as a 505(b)(2) application and supported by sponsor initiated clinical studies such that it may face generic competition after this period of exclusivity. A condition of the approval is the Derm Carc Study and an unfavourable result could cause the FDA to withdraw the NDA for Pennsaid therefore removing Pennsaid from the market in the United States. In any of these scenarios, the Company's future cash flows would be negatively impacted as the Company would lose all or a significant portion of its royalties and potential milestone payments.

As a result, there can be no assurance that the Company will have sufficient capital to fund its ongoing operations, develop or commercialize any further products based on its TTDD or ISR platforms without future financings. There can be no assurance, especially considering the recent economic environment, that additional financing will be available on acceptable terms, or at all. If adequate funds are not available or the commercial launch of Pennsaid is not successful, or Pennsaid is genericized in the U.S. market after the expiry of its exclusivity, the Company may have to substantially reduce or eliminate planned expenditures, terminate or delay clinical trials for its product candidates and curtail product development programs designed to expand the product pipeline. If the Company is unable to obtain additional financings to address its cash deficiencies, the Company may be unable to continue operations.

Uncertainty of Drug Research and Development

There can be no assurance that any of the Company's product candidates will be successfully developed in a timely manner, or that they will prove to be more effective than products based on

existing or new technologies, or that a sufficient number of medical professionals will recommend their use. The risk that a product candidate may fail clinical trials, the Company's inability to successfully complete development, or a decision for financial or other reasons to halt development of any product candidate, particularly in instances where significant capital expenditures have already been made, could have a material adverse effect on the Company.

The return on the Company's investment in Dimethaid AG depends on the successful completion of clinical development and subsequent commercialization of WF10. The results from a Phase 3 AIDS study with WF10 in late-stage AIDS patients were disappointing. For the Company's Phase 2 clinical trial using WF10 as an adjuvant treatment for inoperable pancreatic cancer, the preliminary results of an interim analysis indicate that the primary end point, greater than six months survival, was successfully achieved. However, it is unclear, based on the open-label study design and the data reviewed whether the positive results could be confirmed in a placebo controlled study. The Company is continuing to analyze the interim study results, including a more detailed analysis of the Quality of Life data collected during the study. Clinical trials and development programs with WF10 for other disease indications including the allergic rhinitis and rheumatoid arthritis clinical and preclinical development programs could yield similarly disappointing results, further diminishing or eliminating the Company's ability to recover its investment in Dimethaid AG.

Most of the Company's product candidates are at an early stage in the drug development process and have not been subjected to clinical trials. There can be no assurance that preclinical or clinical testing of the Company's product candidates will yield sufficiently positive results to enable progress toward commercialization and any such trials will take significant time to complete. Unsatisfactory results may prompt the Company to reduce or abandon future testing or commercialization of particular product candidates, and this may have a material adverse effect on the Company.

Patents and Proprietary Technology

There can be no assurance as to the breadth or degree of protection that existing or future patents or patent applications may afford the Company, or that any applications will result in issued patents or that the Company's patents or trademarks will be upheld if challenged. Although the Company believes that its products do not, and will not, infringe valid patents or trademarks or violate the proprietary rights of others, except as described elsewhere in this AIF, it is possible that the Company's existing patent or trademark rights may be deemed invalid or that the use, sale or manufacture of its products may infringe on existing or future patents, trademarks or proprietary rights. If the Company's products infringe the patents or proprietary rights of others, the Company may be required to stop selling or making its products, may be required to modify or rename its products, or may have to obtain licenses to continue using, making or selling them. There can be no assurance that the Company will be able to do so in a timely manner, upon acceptable terms and conditions, or at all. The failure to do any of the foregoing could have a material adverse effect upon the Company. In addition, there can be no assurance that the Company will have sufficient financial or other resources to enforce or defend a patent infringement or proprietary rights violation action. Moreover, if the Company's products infringe patents, trademarks or proprietary rights of others, the Company could, under certain circumstances, become liable for substantial damages, which could also have a material adverse effect.

The Company's key patents for Pennsaid expired in May 2004 in the United States, in 2005 in Canada and in 2006 in the E.U. The Company has filed patent applications for formulations of its follow up product Pennsaid Plus and other pain formulations; however, there can be no

assurance that these patents will be granted or that the use, sale or manufacture of the product will not infringe the patents of others.

Regardless of the validity of the Company's patents, there can be no assurance that others will be unable to obtain patents or develop competitive non-infringing products or processes that permit such parties to compete with the Company

The Company may not be able to protect its intellectual property rights throughout the world as filing, prosecuting and defending patents and trademarks on all of the Company's product candidates, products and product names, when and if they exist, in every jurisdiction would be prohibitively expensive. Competitors may use the Company's technologies and its trademarks in jurisdictions where the Company or its partners have not obtained patent and trademark protection. These products may compete with the Company's products, when and if it has any, and may not be covered by any of its or its partners' patent claims or other intellectual property rights.

The laws of some countries do not protect intellectual property rights to the same extent as the laws of Canada and the United States, and many companies have encountered significant problems in protecting and defending such rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents, trademarks and other intellectual property protection, particularly those protections relating to biotechnology and pharmaceuticals, which could make it difficult for the Company to stop the infringement of its patents. Proceedings to enforce patent rights in foreign jurisdictions could result in substantial cost and divert efforts and attention from other aspects of the business.

Inability to Achieve Drug Development Goals within Expected Time Frames

From time to time, the Company sets targets for and makes public statements regarding its expected timing for achieving drug development goals. These include targets for the commencement and completion of preclinical and clinical trials, studies and tests and anticipated regulatory filing and approval dates. These targets are set based on a number of assumptions that may not prove to be accurate. The actual timing of these forward-looking events can vary dramatically from the Company's estimates, or they might not be achieved at all, due to factors such as delays or failures in clinical trials or preclinical work, scheduling changes at Contract Research Organizations ("CROs"), the need to develop additional data required by regulators as a condition of approval, the uncertainties inherent in the regulatory approval process, delays in achieving manufacturing or marketing arrangements necessary to commercialize product candidates and limitations on the funds available to the Company. If the Company does not meet these targets, including those which are publicly announced, the ultimate commercialization of its products may be delayed and, as a result, its business could be harmed.

Risks Related to Clinical Trials

The Company must demonstrate through preclinical studies and clinical trials that certain of its products being developed are safe and efficacious before the Company can obtain regulatory approval for the commercial sale of such products. The results of preclinical studies and previous clinical trials are not necessarily predictive of future results, and the Company's current product candidates may not have favourable results in later testing or trials. Preclinical tests and Phase 1 and Phase 2 clinical trials are primarily designed to test safety, to study pharmacokinetics and pharmacodynamics and to understand the side effects of products at various doses and schedules. Success in preclinical or animal studies and early clinical trials does not ensure that later large-scale efficacy trials will be successful and such success is not necessarily predictive of

final results. Favourable results in early trials may not be repeated in later trials and positive interim results do not ensure success in final results. Even after the completion of Phase 3 clinical trials, the FDA, the Therapeutic Products Directorate ("TPD") in Canada, the European Medicines Agency ("EMA") in Europe or other regulatory authorities may disagree with the Company's clinical trial design and interpretation of data, and may require additional clinical trials to demonstrate the efficacy of product candidates.

A number of companies in the biotechnology and pharmaceutical industry have suffered significant setbacks in advanced clinical trials, even after achieving promising results in earlier trials and preclinical studies. In many cases where clinical results were not favourable, were perceived negatively or otherwise did not meet expectations, the share prices of these companies declined significantly. Failure to complete clinical trials successfully and to obtain successful results on a timely basis could have an adverse effect on the Company's future business and its common share price.

Prolonged Development Time

It takes considerable time to develop new prescription drug products, to obtain the necessary regulatory approvals permitting sales, to establish appropriate distribution channels and market acceptance, and to obtain insurer reimbursement approvals. This time period is generally from three to more than ten years and it exposes the Company to significant risks, including the development of competing products, loss of investor interest, shifting consumer preferences, changes in personnel and new regulatory requirements. During this lengthy period, the Company often incurs significant development-related costs without obtaining offsetting revenues.

Pennsaid Plus is the follow-on product to Pennsaid and Covidien's development plan for Pennsaid Plus includes a Phase 2 trial that is expected to commence in 2010. This development plan is controlled by Covidien and any delay or issue that may occur during the Phase 2 and/or Phase 3 trials will extend the time to approval. This will also increase the generic risk for Pennsaid when the three year Hatch-Waxman exclusivity expires in November 2012.

Competition

The pharmaceutical industry is characterized by evolving technology and intense competition. The Company is engaged in areas of research where developments are expected to continue at a rapid pace. Many companies, including major pharmaceutical, as well as specialized biotechnology companies, are engaged in activities focused on medical conditions that are the same as or similar to those targeted by the Company. The Company's success depends upon maintaining its competitive position in the research, development and commercialization of topical and transdermally delivered drug products. Competition from pharmaceutical, chemical and biotechnology companies, as well as universities and research institutes, is intense and expected to increase. Many of these organizations have substantially greater research and development capabilities, experience in manufacturing, marketing, financial and managerial resources, and they represent significant competition.

In addition, since the Company's drug development strategy involves applying its topical and transdermal drug delivery technologies and development expertise to formulate topical drugs using existing and unprotected active pharmaceutical ingredients, the Company may face additional regulatory risks if any of its competitors are developing similar drug candidates. Under the 1984 United States federal law, the Drug Price Competition and Patent Term Restoration Act, informally known as the "Hatch-Waxman Act", and C.F.R. 314.108(b)(4) a product filed as a 505(b)(2) application and supported by sponsor initiated clinical studies required as a condition of approval is entitled to three years of exclusivity starting from the effective date of approval or

longer if granted either orphan drug exclusivity (21 CFR 314.20-316.36) or pediatric exclusivity (section 505A of the Act). If the Company's competitors receive the benefit of exclusivity under the "Hatch-Waxman Act" for a drug product similar to one the Company is developing this period of marketing exclusively could prohibit the approval of the Company's drug candidate in the United States for at least three years from the effective date of approval of the competitor's product. Further, approval or filing of any of the Company's future 505(b)(2) applications may be delayed because of patent and exclusivity rights that apply to the listed drug (according to 21 CFR 314.50(i), 314.107, and 314.108 and section 505A of the Act).

Competition for Pennsaid

Several major pharmaceutical companies have developed oral COX-2 selective NSAIDs designed to reduce gastrointestinal side effects associated with other types of NSAIDs. Many of these products have been taken off the market or drug development has stopped in response to safety concerns. Those that remain, represent competition for market share. While the Company believes that topical administration gives Pennsaid a better safety profile than oral NSAIDs and Cox-2 selective medications, it may be subject to regulations and regulatory decisions of governing bodies, such as the FDA in the United States, including label warnings that apply to NSAIDs generally.

In the United States, other topical products for the treatment of medical conditions similar to the indication for Pennsaid have been available over the counter for many years; however, the first topical prescription NSAIDs were only recently approved and launched and will provide competition for market share. If patients and practitioners believe these recently approved and launched products provide pain relief it may be difficult to convince them to use Pennsaid or conversely, if they do not believe that they provide pain relief they may create a perception that all topically applied products have similar efficacy, making it more difficult to convince physicians and their patients of the value of Pennsaid.

Pennsaid faces competition in the United States from at least two other topically applied diclofenac drug products that were approved for marketing in 2007 by the FDA. The FLECTOR[®] Patch has been approved by the FDA for the topical treatment of acute pain due to minor strains, sprains and contusions and was launched by Alpharma Inc. (subsequently acquired by King Pharmaceuticals, Inc.) in January 2008. The FLECTOR[®] Patch contains the NSAID diclofenac epolamine. The second drug product, Novartis' Voltaren[®] Gel which contains the NSAID diclofenac sodium, was approved by the FDA for the relief of the pain of OA of joints amenable to topical treatment, such as the knees and those of the hand and was launched by Endo Pharmaceuticals Inc. in the first half of 2008. Both of these topical products are benefitting from being launched in the United States market prior to Pennsaid and they have achieved respectable sales levels. In 2008, Health Canada approved Novartis' Voltaren Emulgel[™] and it has been available in Canada without a prescription since October 2008. In Europe and Asia, several major pharmaceutical companies market these and other topical NSAIDs that compete against Pennsaid in countries where it is marketed.

In addition to the recently approved products, the Company is also aware of other companies that are developing topical NSAID products for the United States and other markets that may present additional competition in the future. Like Pennsaid, these drugs may reduce the incidence of some of the systemic side effects associated with oral NSAIDs.

In addition, since Pennsaid's United States' patents have expired and it was filed with the FDA as a 505(b)(2) application it may face generic competition as early as November 4, 2012. Under the 1984 United States federal law, the Drug Price Competition and Patent Term Restoration Act,

informally known as the "Hatch-Waxman Act", and C.F.R. 314.108(b)(4), Pennsaid a product filed as a 505(b)(2) application and supported by sponsor initiated clinical studies required as a condition of approval is entitled to three years of exclusivity starting from its effective date of approval, November 4, 2009.

Anticipating this generic risk, the Company began exploring formulations to improve upon the original Pennsaid formulation in late 2004. The Company has completed preliminary testing of a new, improved version of Pennsaid, currently referred to as Pennsaid Plus. While no clinical trials of this product have taken place to-date, in vitro and in vivo tests have indicated that Pennsaid Plus may increase the transport of diclofenac, the active therapeutic drug in both original Pennsaid and Pennsaid Plus, through the skin with less frequent dosing than Pennsaid providing Pennsaid Plus with potential advantages over Pennsaid and with enhanced patent protection. However, there can be no assurance that Pennsaid Plus will show clinically significant efficacy, receive patent protection or that it will meet all government regulatory testing requirements. In addition, under the terms of the U.S. Licensing Agreement, Covidien has assumed responsibility of the development program for Pennsaid Plus.

Competition for WF10

Several major pharmaceutical companies are at various stages of developing products targeting the immune system. Some of these products have already been approved for marketing and as such, represent competition for market share.

The Company's own experience with WF10 is limited. The last Phase 3 HIV/AIDS trial produced disappointing results and the early-stage pancreatic cancer trial at the University of Heidelberg in Germany took much longer than anticipated to recruit subjects. While the interim analysis of the study results was positive, the open-label study design does not allow the Company to draw definitive conclusions about the efficacy of WF10 in the treatment of the targeted indication. As a result of the recruiting issues and the determination that completing the study would not provide more conclusive efficacy data, the Company terminated the trial in December 2008. The Company expects to commence an allergic rhinitis trial in 2010; however, it cannot do so until it receives written authorization from the BfArM. If this trial is not successful, the Company may not recommence a similar trial and, even if it does undertake further WF10 clinical trials, such trials may not be completed successfully.

Obtaining Government and Regulatory Approvals

The Company may encounter difficulties or excessive costs in securing necessary approvals or licenses in Canada and the United States, obstacles that could delay or prevent the Company from marketing its products.

The Company may not obtain regulatory approvals in countries outside Canada and the United States. It may be required to incur significant costs in obtaining or maintaining foreign regulatory approvals. Failure to obtain necessary regulatory approvals, the restriction, suspension or revocation of existing approvals or any other failure to comply with regulatory requirements, could have a material adverse effect on the Company's business, financial condition and operational results.

Changes in Government Regulation

The business of the Company may be adversely affected by such factors as changes in the regulatory environment with respect to intellectual property, regulation, export controls or product marketing approvals. Such changes remain beyond the Company's control and have an unpredictable impact.

Generic Drug Manufacturers

Regulatory approval for competing generic drugs can be obtained without investing in the same level of costly and time-consuming clinical trials the Company has conducted or might conduct in the future. Due to the substantially reduced development costs, generic drug manufacturers are often able to charge much lower prices for their products than the original developer. The Company may face competition from manufacturers of generic drugs on some of the products it commercializes, since a number of the Company's patents have expired. If the Company faces generic competition the prices at which the Company's products are sold, the royalty rates the Company receives, the volume of product sold and the overall revenues it receives may be substantially reduced.

Reimbursement and Product Pricing

There can be no assurance that Pennsaid will be successfully commercialized in current markets or that the additional regulatory approvals necessary to commercialize Pennsaid in other markets will be obtained. In Canada, private health coverage insurers have generally approved reimbursement of Pennsaid costs, but government health authorities have not approved such reimbursement. The Company's ability to realize the full commercial potential of Pennsaid or other therapeutic products may depend on the extent to which patient costs are reimbursed by government health administration authorities, private health coverage insurers (outside of Canada) and other organizations. Obtaining reimbursement approval for a product from each government or other third-party payor is a time consuming and costly process that could require the Company to provide supporting scientific, clinical and cost effectiveness data for the use of its products to each payor. In certain territories, this process is the responsibility of the licensee and the Company will have little financial impact from this process. The Company may not have or be able to provide data sufficient to gain acceptance with respect to reimbursement. Even when a payor determines that a product is eligible for reimbursement they may impose coverage limitations that preclude payment for some approved uses or that full reimbursement may not be available for the Company's products.

Furthermore, even after approval for reimbursement for Pennsaid is obtained from private health coverage insurers or government health authorities, it may be eliminated at any time. Significant uncertainty exists as to the reimbursement status of newly approved healthcare products and there can be no assurance that third party coverage will be sufficient to give the Company an appropriate return on its investment in developing existing or new products. Increasingly, government and other third-party payers are attempting to contain expenditures by limiting coverage and reimbursement levels for new therapeutic products. Inadequate coverage or reimbursement could adversely affect market acceptance of the Company's products. Third-party payers increasingly challenge the pricing of pharmaceutical products. Moreover, the trend toward managed healthcare in the United States, the growth of organizations such as health maintenance organizations, and legislative proposals to reform healthcare and government insurance programs, could significantly influence the purchase of healthcare services and products, resulting in lower prices and reduced demand for the Company's products. We expect recent changes in the Medicare program and increasing emphasis on managed care to continue to put pressure on pharmaceutical product pricing.

In the United States, each third party payor plan is organized into tiers and the number of tiers will vary. Each tier represents different reimbursement amounts. There is no guarantee that the Company's products will be reimbursed even at tiers where the reimbursement amounts are minimal.

In some countries, particularly the countries of the E.U., the pricing of prescription pharmaceuticals is subject to government control. In these countries, pricing negotiations with governmental authorities can take considerable time and delay the introduction of a product to the market. To obtain reimbursement or pricing approval in some countries, the Company may be required to conduct a clinical trial that compares the cost effectiveness of its product candidate to other available therapies. If reimbursement of the Company's product is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, its business could be adversely affected. In addition, any country could pass legislation or change regulations affecting the pricing of pharmaceuticals in ways adverse to the Company before or after a regulatory agency approves any of its product candidates for marketing. While the Company cannot predict the likelihood of any legislative or regulatory changes, if any government or regulatory agency adopts new legislation or new regulations, the Company's business could be harmed

Dependence on Sales and Marketing Partnerships

The Company has limited sales and marketing experience and lacks financial and other resources to undertake marketing and advertising activities worldwide. Accordingly, the Company intends to rely on marketing arrangements, including possible joint ventures, licensing or other third-party arrangements, to distribute its products in all applicable jurisdictions. The Company faces, and will continue to face significant competition in seeking appropriate partners and distributors. Moreover, collaboration and distribution arrangements are complex and time consuming to negotiate, document and implement. Therefore, there can be no assurance that the Company will be able to find marketing and distribution partners in applicable jurisdictions or be able to enter into any marketing and distribution arrangements on any terms, acceptable or not. Moreover, there can be no assurance that its partners will dedicate the resources needed to successfully market and distribute the Company's products and maximize sales. In addition, under these arrangements: disputes may arise with respect to payments that the Company or its partners believe are due under such distribution or marketing arrangements; a partner or distributor may develop or distribute products that compete with the Company's products or they may terminate the relationship.

The Company has no influence in sales and marketing activities for Pennsaid in Canada. Decisions impacting sales and marketing efforts are made by Paladin which sells and markets Pennsaid in Canada. There is no guarantee that Paladin will continue to be successful in selling and marketing Pennsaid in Canada. If this event was to occur, it could have an adverse effect on the Company's Canadian product sales and cash resources.

The Company has minimal influence in sales and marketing activities for Pennsaid in the United States. Although Nuvo has been provided two seats on the JSC that was established to monitor the commercial launch of Pennsaid the Company no longer has control over the clinical development program for Pennsaid Plus nor the commercial launch of Pennsaid; those responsibilities having been assumed by Covidien. Although the U.S. Licensing Agreement includes minimum spending and detailing commitments from Covidien in its commercialization efforts for Pennsaid, there is no guarantee that Covidien will successfully launch Pennsaid in the United States. If this were to occur, it could have an adverse effect on the Company's potential royalty income, sales milestone payments and cash resources. In addition, under the terms of the U.S. Licensing Agreement, Covidien has taken control of the development program for Pennsaid Plus. As the Company no longer controls the program, it will rely upon Covidien to execute a successful drug development program and ultimately gain U.S. approval for Pennsaid

Plus. If they fail during this process, it could have an adverse effect on the Company's future revenue from the U.S. and other jurisdictions where it has licensed Pennsaid Plus.

Personnel

The Company depends upon certain key members of its scientific and management teams. The loss of any of these individuals could have a material adverse effect on the Company. The Company does not maintain key-man insurance on any employee.

The Company's success depends, in large part, on its ability to continue to attract and retain qualified scientific and management personnel. The Company faces intense competition for such personnel. It may not be able to attract and retain qualified management and scientific personnel in the future. Also, it must provide training for its employee base due to the highly specialized nature of pharmaceutical products.

Further, the Company expects that its potential expansion into specific areas and activities requiring new or additional expertise, such as in the areas of research and development, preclinical studies, CMC work, clinical trials, regulatory approvals, sales and marketing will place additional requirements on management, operational and financial resources. The Company expects these demands will require an increase in the number of management and scientific personnel and development of additional expertise by existing personnel. The failure to attract and retain such personnel, or to develop such expertise, could materially adversely affect prospects for its success. In addition, to attract qualified personnel the Company may be required to establish offices in different locations. Failure of personnel in different locations to work effectively together could materially adversely affect the Company's success.

Given these potential challenges, current personnel may be unable to adapt or may not have the appropriate skills and the Company may fail to assimilate and train new employees. Highly skilled employees with the education and training required, especially employees with significant experience and expertise in drug delivery systems, are in high demand. Once trained, the Company's employees may be hired by its competitors.

Potential Product Liability

The Company may be subject to product liability claims associated with the use of its products either after their approval or during clinical trials, and there can be no assurance that liability insurance will be available on commercially reasonable terms or at all. Product liability claims might also exceed the amounts, or fall outside, of such coverage. Product liability claims against the Company, regardless of their merit or potential outcome, could be costly and divert the Company's management's attention from other business matters, or adversely affect its reputation and the demand for its products.

Manufacturing and Supply Risks

The Company purchases key raw materials necessary for the manufacture of its products from a limited number of suppliers around the world. In the case of DMSO (one of the key ingredients in Pennsaid) the Company has a supply agreement with a single supplier based in the United States to purchase from that supplier all of the Company's requirements for pharmaceutical grade DMSO until October 31, 2012 using the supplier's patented process. It may be difficult to find another manufacturer if the supplier is unable to supply the Company with a sufficient amount of DMSO or if the Company is forced for any other reason to find another supplier. It could take another supplier a significant period of time to develop and certify the necessary processes to manufacture the product on terms acceptable to the Company. There may not be suppliers that

are able to meet the Company's volume or quality requirements at a price that is as favourable as those it has with its current supplier. Any operating, production or quality problems experienced by these suppliers that result in a reduction or interruption in supply could significantly delay the manufacture and sale of the Company's products.

In addition, the FDA and other regulatory agencies, require that raw material manufacturers comply with all applicable regulations and standards pertaining to the manufacture, control, testing and use of the raw materials as appropriate. For the active pharmaceutical ingredient ("API") or critical raw materials depending on the drug product, this means compliance to current GMPs for APIs and submission of all data related to the manufacture, control and testing of the API for quality, purity, identity and stability as well as a complete description of the process, equipment, controls and standards used for the production of the API. This is usually submitted to the FDA in the form of a Drug Master File ("DMF") by the manufacturer and referenced by the sponsor of the NDA. The DMF information and data is reviewed by the FDA as a critical component of the approvability of the NDA.

As a result, in the case where only one supplier of a particular API or critical raw material meets all of the FDA's (or other regulatory agencies) requirements and has a DMF (or similar filing) on file with the FDA the Company is at risk should a supplier violate GMP, fail an FDA inspection, terminate access to its DMF, be unable to manufacture product, choose not to supply the Company or decide to increase prices. In the case of DMSO, the Company has only one approved supplier for all jurisdictions in which Pennsaid has been approved. For its API, diclofenac sodium, the Company has two approved suppliers for Canada and Europe but only one approved supplier for the United States. For some of the Company's other raw materials required to manufacture Pennsaid, Oxoferin™ and WF10 the Company currently has only one approved supplier.

In addition, the Company could be subject to various import duties applicable to both finished products and raw materials, and it may be affected by other import and export restrictions as well as developments with an impact on international trade. Under certain circumstances, these international trade factors could affect manufacturing costs (which will, in turn, affect the Company's margins), as well as the wholesale and retail prices of manufactured products.

The Company's current manufacturing capabilities are limited to its site in Varennes, Québec, which is the sole manufacturer of Pennsaid for all markets and its site in Wanzleben, Germany which produces OXO-K993, the active ingredient in WF10 and Oxoferin™. The Company has never achieved capacity in these facilities, although it has manufactured Pennsaid and OXO-K993 for existing markets and produced clinical batches. This exposes the Company to the following risks, any of which could delay or prevent the commercialization of its products, result in higher costs or deprive it of potential product revenues:

- The Company may encounter difficulties in achieving volume production, quality control and quality assurance, as well as with shortages of qualified personnel. Accordingly, the Company might not be able to manufacture sufficient quantities to meet its clinical trial needs or to commercialize its products.
- The Company's manufacturing facilities are required to undergo satisfactory current GMP inspections prior to regulatory approval and are obliged to operate in accordance with FDA, European and other nationally mandated GMPs, which govern manufacturing processes, stability testing, record keeping and quality standards. A failure to establish and follow GMPs and to document adherence to

such practices may lead to significant delays in the availability of material for clinical studies and may delay or prevent filing or approval of marketing applications for the Company's products.

- Changing manufacturing locations would be difficult and the number of potential manufacturers is limited. Changing manufacturers generally requires re-validation of the manufacturing processes and procedures in accordance with FDA, European and other nationally mandated GMPs. Such re-validation may be costly and would be time consuming. It would be difficult or impossible to quickly find replacement manufacturers on acceptable terms, if at all.

The Company's manufacturing facilities are subject to ongoing periodic unannounced inspection by the FDA, and corresponding state and foreign agencies, including European ones, to ensure strict compliance with GMPs and other government regulations. Failure by the Company to comply with applicable regulations, could result in sanctions being imposed on it, including fines, injunctions, civil penalties, failure of the government to grant review of submissions or market approval of drugs, delays, suspension or withdrawal of approvals, seizures or recalls of product, operating restrictions, facility closures and criminal prosecutions, any of which could harm the Company's business.

Hazardous Materials and Environmental

The Company's products involve the use of hazardous materials, and as a result it is exposed to potential liability claims and costs associated with complying with laws regulating hazardous waste. The Company's research and development and manufacturing activities involve the use of hazardous materials, including chemicals, and are subject to federal, provincial and local laws and regulations governing the use, manufacture, storage, handling and disposal of hazardous materials and waste products in the jurisdictions where they reside. However, accidental injury or contamination from these materials may occur. In the event of an accident, the Company could be held liable for any damages, which could exceed its available financial resources. In addition, the Company may be required to incur significant costs to comply with environmental laws and regulations in the future.

Acquisition and Integration of Complementary Technologies or Businesses

The Company may pursue product or business acquisitions that could complement or expand its business. However, it may not be able to identify appropriate acquisition candidates in the future. If an acquisition candidate is identified, the Company may not be able to successfully negotiate the terms of any such acquisition or finance such acquisition. Any such acquisition could result in unanticipated costs or liabilities, diversion of management's attention from the core business, the expenditure of resources and the potential loss of key employees, particularly those of the acquired organizations. In addition, the Company may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future, which may harm its business.

To the extent the Company issues common shares or other rights to finance any acquisition, existing shareholders may be diluted. They may also result in goodwill and other long-lived assets that are subject to impairment tests, which could result in future impairment charges.

Losses due to Foreign Currency Fluctuations

The Company anticipates that the majority of the revenue from commercialization of its product candidates may be in currencies other than Canadian dollars. Fluctuation in the exchange rate of

the Canadian dollar relative to these other currencies could result in the Company realizing a lower profit margin on sales of its product candidates than anticipated at the time of entering into such commercial agreements. Adverse movements in exchange rates could have a material adverse effect on the Company's financial condition and results of operations.

International Operations

The Company has operations outside of Canada, primarily in Europe and the United States, in order to research, develop, market, distribute and manufacture certain of its products and may expand further in the future. Participation in international markets requires resources and management attention and subjects the Company to business risks, including the following:

- different regulatory requirements for approval of its product candidates;
- dependence on local distributors;
- longer payment cycles and problems in collecting accounts receivable;
- adverse changes in trade and tax regulations;
- absence or substantial lack of legal protection for intellectual property rights;
- difficulty in managing widespread operations;
- political and economic instability;
- increased costs and complexities associated with financial reporting; and,
- currency risks.

The occurrence of any of these or other factors may cause the Company's international operations not to be successful and could lower the prices at which it can sell its products or otherwise have an adverse effect on its operating results.

Taxes

Significant judgment is required in determining the Company's provision for income taxes, accrual for capital taxes and claims for investment tax credits ("ITCs") related to qualifying scientific research and experimental development ("SR&ED") expenditures. Various internal and external factors may have favorable or unfavorable effects on future provisions for income taxes and the Company's effective income tax rate. These factors include, but are not limited to, changes in tax laws, regulations and/or rates, results of audits by tax authorities, changing interpretations of existing tax laws or regulations, changes in estimates of prior years' items, future levels of research and development spending and changes in overall levels of income before taxes. Furthermore, new accounting pronouncements or new interpretation of existing accounting pronouncements can have a material impact on the Company's effective income tax rate.

The Company could be impacted by certain tax treatments for various revenue streams in different taxing jurisdictions. The Company is subject to withholding taxes on certain of its revenue streams. The withholding taxes rates that have been used are based on the interpretation of specific tax acts and related treaties. If a tax authority has a different interpretation from the Company's it could potentially reduce the amounts received by the Company.

On August 16, 2005, the Company sold 100% of the common shares of its subsidiary DHCL (renamed Squire and amalgamated with Paladin on January 1, 2009) to Paladin. Under the terms of the share purchase agreement ("SPA") with Paladin, the Company provided

representations and warranties with respect to the status of the Company's tax accounts and its tax assets, which consisted of noncapital losses, ITCs and undeducted SR&ED expenditures. If the amounts represented are incorrect then the Company is required to indemnify Paladin for a portion of its losses.

In July and August 2008, Paladin received notices of reassessment (the "2008 CRA Reassessments") relating to its taxation years ending August 16, 2005 and July 31, 2006 and 2007 ("the Tax Years") from the Canada Revenue Agency ("CRA") containing adjustments related to certain transactions occurring in the tax year ended August 16, 2005 (the "Reassessed Transactions") that impact all of the Tax Years. Certain provincial tax authorities also reassessed certain of the Tax Years and other provincial tax authorities could have proposed similar adjustments as a result of the CRA reassessments. The notices of reassessment, if they stand, could cause the Company to breach certain representations and warranties in the SPA.

The Company disagreed with the position taken by the CRA and believed it to be without merit. Paladin contested the reassessments through the CRA appeals process and filed a Notice of Objection ("NOA") with the CRA in October 2008. In January 2010, the CRA responded to the NOA by issuing reassessments for the Tax Years ("January 2010 Reassessments") that reversed all of the adjustments made by the CRA relating to the Reassessed Transactions, in essence agreeing with Paladin's original filing position. The January 2010 Reassessments have been forwarded to the provincial tax authority to begin the process of having the adjustments for the Reassessed Transactions reversed as the province previously agreed in writing to be bound by the CRA's decision. The Company estimates its remaining potential obligation under the indemnification provisions of the SPA relating to the provincial reassessments is in the range of \$0.8 million to \$1.2 million, including interest and penalties. The SPA also requires the Company to indemnify Paladin for out-of-pocket costs (including attorneys' and experts' fees) incurred by Paladin that are caused by the Company's breach of its representations and warranties contained in the SPA. If a favourable resolution is not achieved on the remaining provincial reassessments, it could have a material adverse impact on the Company's cash flows.

Paladin is a "Large Corporation" under subsection 225.1(8) of the Income Tax Act and as a result, in September 2008 the CRA took action to collect 50% of the amounts reassessed in the 2008 CRA Reassessments. Paladin suggested that it may have a claim against the Company pursuant to the SPA for a portion of the collected amount. However, on November 17, 2008 the Company and Paladin signed an agreement (the "Letter Agreement"), whereby, the Company agreed to provide security (the "Indemnity Security") to Paladin for potential indemnity obligations that arise from or relate to the CRA Reassessments and to pay half of Paladin's ongoing out-of-pocket costs to contest the CRA Reassessments. The Indemnity Security charges the revenue from Pennsaid sales in Europe, a mortgage over Nuvo's manufacturing facility in Québec, a charge on all manufacturing assets in Québec and all Pennsaid inventory and receivables as well as all intellectual property rights required to manufacture and market Pennsaid in Canada. In exchange, Paladin agreed not to pursue any claims against the Company for reimbursement of any funds that Paladin may have paid or may be required to pay in connection with the CRA Reassessments while their contestation is continuing, except in circumstances where the Company has or is determined to have become insolvent as defined in the Letter Agreement.

Volatility of Share Price

Market prices for pharmaceutical-related securities, including those of the Company, have been historically volatile and subject to substantial fluctuations. Future announcements concerning the Company or its competitors-including the results of testing, technological innovations, new

commercial products, marketing arrangements, government regulations, developments concerning regulatory actions affecting the Company's products and its competitors' products in any jurisdiction, developments concerning proprietary rights, litigation, additions or departures of key personnel, cash flow and public concerns about the safety of the Company's products and economic conditions and political factors in the United States, Europe, Canada or other countries may have a significant impact on the market price of the Common Shares. In addition, there can be no assurance that the Common Shares will continue to be listed on the TSX.

Compliance with Laws and Regulations Affecting Public Companies

Any future changes to the laws and regulations affecting public companies, as well as the required conversion to IFRS in 2011 by Canadian publicly accountable entities as mandated by the Canadian Accounting Standards Board, compliance with existing provisions of Multilateral Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings of the Canadian Securities Administrators and the other applicable Canadian securities laws and regulation and related rules and policies, may cause the Company to incur increased costs as it evaluates the implications of new rules and responds to new requirements. Delays, or a failure to comply with the new laws, rules and regulations could result in enforcement actions, the assessment of other penalties and civil suits.

The new laws and regulations may make it more expensive for the Company to provide indemnities to the Company's officers and directors and may make it more difficult to obtain certain types of insurance, including liability insurance for directors and officers; as such, the Company may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for the Company to attract and retain qualified persons to serve on its Board of Directors, or as executive officers. The Company may be required to hire additional personnel and utilize additional outside legal, accounting and advisory services - all of which could cause general and administrative costs to increase beyond what the Company currently has planned. The Company is continuously evaluating and monitoring developments with respect to these laws, rules and regulations, and it cannot predict or estimate the amount of the additional costs it may incur or the timing of such costs.

The Company is required annually to review and report on the effectiveness of its internal control over financial reporting in accordance with Multilateral Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings of the Canadian Securities Administrators. The results of this review are reported in the Company's Annual Report and in its Management's Discussion and Analysis of Results of Operations and Financial Condition. The Company's Co-Chief Executive Officers and Chief Financial Officers are required to report on the effectiveness of the Company's internal controls over financial reporting.

Management's review is designed to provide reasonable assurance, not absolute assurance that all material weaknesses existing within the Company's internal controls are identified. Material weaknesses represent deficiencies existing in the Company's internal controls that may not prevent or detect a misstatement occurring which could have a material adverse affect on the quarterly or annual financial statements of the Company. In addition, management cannot provide assurance that the remedial actions being taken by the Company to address any material weaknesses identified will be successful, nor can management provide assurance that no further material weaknesses will be identified within its internal controls over financial reporting in future years.

If the Company fails to maintain effective internal controls over its financial reporting, there is the possibility of errors or omissions occurring or misrepresentations in the Company's disclosures which could have a material adverse effect on the Company's business, its financial statements, and the value of the Company's Common Shares.

Additional Risks

Additional risks that could be materially adversely affect the Company's business or an investment in its common shares include, but are not limited to:

- government assistance for certain drug development programs;
- limits on the marketing approval for the Company's products such that they are subject to ongoing regulatory review and regulatory requirements;
- inadequate patient enrolment for our current trials or future clinical trials;
- rapid technological change that could make our products or drug delivery technologies obsolete;
- unsatisfactory performance by third parties whom the Company relies upon to conduct, supervise and monitor its clinical trials and preclinical studies;
- further dilution and a declining share price from additional equity financings;
- the inability to raise future capital when and if required;
- public company requirements that may strain resources and distract management;
- an inability to achieve and maintain profitability;
- product liability claims;
- issue of preferred shares;
- shareholders' rights plan may prevent or delay a change in control;
- an inability to manage the growth of the Company;
- a failure to maintain DEA registrations or compliance;
- an inability to protect know how and trade secrets; and,
- securities industry analyst research reports.

Management's Responsibility for Financial Reporting

Disclosure Controls

Disclosure controls and procedures ("DCP") are designed to provide reasonable assurance that information required to be disclosed by the Company in its filings under Canadian securities legislation is recorded, processed, summarized and reported in a timely manner. The system of DCP includes, among other things, the Company's Corporate Disclosure and Code of Conduct and Business Ethics policies, the review and approval procedures of the Corporate Disclosure Committee, and continuous review and monitoring procedures by senior management.

As at December 31, 2009, the system of DCP has been evaluated, under the supervision of the Company's Chairman and Co-Chief Executive Officer, President and Co-Chief Executive Officer, and Executive Vice President and Chief Financial Officer. Based on this evaluation, the Company's management has concluded that DCP are effective and provide reasonable assurance that all material information relating to the Company would be made known to them. While the Co-Chief Executive Officers and Chief Financial Officer believe that the Company's DCP provide reasonable assurance, they are also aware that any control system can only provide reasonable, not absolute, assurance of achieving its control objectives.

Internal Controls over Financial Reporting

Management is also responsible for the design of ICFR within the Company in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, the design of any system of control is based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all future events, no matter how remote, or that the degree of compliance with the policies or procedures may not deteriorate. Accordingly, even effective ICFR can only provide reasonable, not absolute, assurance of achieving the control objectives for financial reporting.

The design and operating effectiveness of the Company's ICFR were evaluated, under the supervision of the Company's Co-Chief Executive Officers and Chief Financial Officer, in accordance with criteria established in the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Multilateral Instrument 52-109 as at December 31, 2009. Based on this evaluation, the Company's management has concluded that ICFR are effective and provided reasonable assurance that its financial reporting is reliable and its consolidated financial statements were prepared in accordance Canadian GAAP.

Changes to Internal Controls over Financial Reporting

There were no changes to ICFR that occurred during the year that has materially affected, or is reasonably likely to materially affect, the Company's ICFR in Canadian GAAP.

Additional Information

Additional information relating to the Company, including the Company's most recently filed annual information form and information circular, can be found on SEDAR at www.sedar.com