

# **SQI Diagnostics Inc.**

Management's Discussion and Analysis of Financial  
Condition and Results of Operations

**December 31, 2008**

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

*This discussion and analysis covers the financial statements for the fiscal quarter ending December 31, 2008 and 2009, prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). The fiscal year end of SQI Diagnostics Inc. ("SQI" or "Company") is September 30<sup>th</sup>.*

*All amounts are expressed in Canadian dollars unless otherwise indicated.*

*This discussion and analysis was performed by management using information available as at 20 February, 2009. Certain portions of this document including management's assessment of the Company's future plans and operations contain forward-looking statements that involve substantial known and unknown risks and uncertainties. These forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Company's control, including the impact of general imprecision of reserve estimates, taxation policies, competition from other producers, stock market volatility and the ability to access sufficient capital from internal or external sources. The Company's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that the Company will derive therefrom. Additional information relating to the Company is available by accessing the SEDAR website at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.sqidiagnostics.com](http://www.sqidiagnostics.com).*

### OVERVIEW

SQI Diagnostics Inc. is a medical systems company that develops proprietary human diagnostic technology in multiplexing, miniaturization and automation. We provide laboratories the ability to simultaneously analyze multiple biomarkers, deliver accurate and quantitative patient results in less time, significantly reduce labor, and increase profits when compared with current diagnostic instrumentation. The Company has received Canadian regulatory approval for, and has CE Marked its SQiDworks platform together with its QuantiSpot RA test kit used to detect and quantify a panel of biomarkers to aid in the diagnosis of rheumatoid arthritis. The Company is developing and commercializing other test kits for the autoimmune disease market and plans to pursue commercialization of tests in infectious disease and allergen testing in the future. The Company plans to seek regulatory approvals and clearances to sell these additional tests globally starting with the North American markets and Europe.

The Company's proprietary SQiDworks™ instrument and QuantiSpot™ consumable tests are together an immunoassay system capable of providing many of the diagnostic tests currently performed in reference laboratories engaged in testing human blood for a wide range of disease markers. The Company will provide to the laboratory diagnostic testing market:

- (a) Fully automated, microarray-based test platforms enabling laboratory customers to generate multiple patient results with one unit of 'test effort', and
- (b) A menu of tests to support a wide range of disease diagnoses in each of the disease segments we are targeting. The Company's first launch market is in the autoimmune disease segment with its QuantiSpot RA™ panel for aiding in the diagnosis of rheumatoid arthritis. The Company is developing additional test kits within the autoimmune disease segments including but not restricted to tests that aid in the diagnosis of antiphospholipid syndrome (APS), thyroid disease, celiac disease and

Crohn's disease. Other autoimmune disease, infectious disease and allergen panels are expected to follow.

From 2003 to present, the Company has been primarily involved in research, development and commercialization activities related to its core technology platform (together SQiDworks™ and QuantiSpot™). The Company has expended significant resources to create and protect its technology platform through the filing of patents and in building an automated instrument and multiplexed assay platform. The Company has also incurred costs associated with gathering market intelligence from prospective customers and in fostering partnership opportunities with potential novel biomarker collaborators and OEM device manufacturers.

### **Commercial Development Current Status**

During the quarter ended December 31, 2008, the Company completed validation and multi-site validation studies for its SQiDworks platform and QuantiSpot RA test kit. Successful completion of these validation studies lead to the Company filing submissions seeking clearance from the United States Food & Drug Administration ("FDA") to market and sell the products; for licenses from Health Canada to market and sell the products in Canada; and, authority to CE Mark the products for sale in the European Union. During the period ending December 31, 2008 the Company received its license from Health Canada clearing it to market and sell the SQiDworks platform with the QuantiSpot RA test kit in Canada. The information below provides an overview of the Company's achievements during the period ending December 31, 2008:

- Submitted 510(k) Pre-Market clearance submission for the SQiDworks™ Platform and QuantiSpot RA kit;
- Submitted application and received Health Canada license for the SQiDworks™ Platform and QuantiSpot RA kit;
- Submitted CE Mark authorization for the QuantiSpot RA kit
- Built customer service and satisfaction processes;
- Sales & Marketing - redesigned SQI branding and key messages of "Confidence, Profit, Growth" and refreshed the SQI Diagnostics website;
- Initiated development of enhanced next-generation QuantiSpot RA release to include CCP IgA;
- Filed four patents including:
  - IgX-Plex™ and IVDplus plex™ technologies with the potential to secure our technological advantage on antibody sub-class multiplexing
  - Synthetic protein mimetic molecules to optimize multiplex binding and increasing specificity
  - A method for increasing fluorescent signal intensity of microarray matrices
  - A two-phase method for optimizing microarray surfaces and vapour content thus optimizing fluorescent signal to background ratios and ultimately improving assay sensitivity; and,
- Filed trademarks to support new branding IgXplex™ and IVD plus plex™ to support our competitive differentiation

### **Corporate Financing Transactions**

On April 26, 2007 umedik Inc. amalgamated with 6701914 Canada Inc., a wholly owned subsidiary of SQI to become a wholly owned subsidiary of SQI through the reverse takeover of SQI, formerly known as Emblem Capital Inc. ("Emblem"), a company whose shares were listed

for trading on TSX Venture Exchange as a Capital Pool Company (CPC) just prior to the transaction. For more information regarding the transaction refer to the year end 2007 annual financial statements and Management's Discussion and Analysis.

In May, 2008 the Company entered into a financing arrangement with the Royal Bank of Canada to borrow \$730,000 in a non-revolving term credit facility. The interest and principal were originally due by November 31, 2008, or upon receipt of 2006 and 2007 SR&ED investment tax credit refund, whichever was sooner. The Company has since extended the due date to March 31, 2009 or upon receipt of 2006 and 2007 SR&ED investment tax credit refund, whichever is sooner. Subsequent to the period end the Company was in receipt of a notice from the Canada Revenue Agency providing notice that its 2006 and 2007 SR&ED investment tax claim had been finalized resulting in a cash refund of \$1,016,302 excluding accrued interest. The Company will use the refund to retire the credit facility.

During the period ending December 31, 2008 and subsequent to the period end, the Company completed a non-brokered private placement in two tranches for total gross proceeds of \$4,664,375. The first tranche, closed December 23, 2008, resulted in gross proceeds of \$3,000,000 through issuance of 2,400,000 common shares at \$1.25 per common share. The second tranche, closed after the period end on January 21, 2009, resulted in gross proceeds of \$1,664,375 through the issuance of 1,331,500 shares at \$1.25 per common share. The shares issued through the private placement are subject to a four month hold period. The Company paid a finder's fee in relation to the private placement satisfied through the issuance of 236,800 finder's warrants with an exercise price of \$1.90 and expiring on December 23, 2011; the issuance of 106,520 finder's warrants with an exercise price of \$1.25 and expiring on January 21, 2011; and, through the payment of \$133,150.

### **Operational Risks**

The Company is subject to various operational risks. Factors that could cause operational results or events to differ materially from management's current expectations include, but are not limited to:

- changing competitive technology and market conditions;
- the successful and timely completion of clinical validation studies at partner sites;
- the failure to obtain requisite regulatory approvals (including the approval of the FDA) for the Company's diagnostic tests in a timely manner, if at all, and other inherent uncertainties related to the regulatory approval process;
- the Company's ability to successfully commercialize additional QuantiSpot™ tests in the autoimmune disease market;
- the ability to generate sales of the Company's platforms and tests; and,
- the ability of the Company to fund its cash requirements from internal and external sources.

Management seeks to mitigate these risks, and others, primarily through retaining experienced employees and advisors who have expertise in the scientific, medical, business, regulatory, manufacturing and operational disciplines of automated platform integration and immunoassay diagnostic test development.

### **CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES**

Financial statements are prepared in accordance with Canadian GAAP. These accounting principles require management to make certain estimates and assumptions. Management

believes that the estimates and assumptions relied upon are reasonable, based upon information available at the time that these estimates and assumptions are made. Actual results could differ from these estimates.

The significant accounting policies that management believes are the most critical in fully understanding and evaluating the reported financial results include the following:

#### **Patents**

The costs relating to patent fees are deferred and amortized over 10 years on a straight-line basis. Patents are recorded net of accumulated amortization for December 31, 2008 of \$417,697 (September 30, 2008 of \$402,779)

#### **Research and Development Costs**

Research costs are charged to earnings in the period in which they are incurred. Development costs are expensed as incurred or deferred if they meet the criteria for deferral under Canadian generally accepted accounting principles and are expected to provide future benefits with reasonable certainty. At December 31, 2008, the Company was in development of its pipeline of novel tests for its diagnostic system. Deferral criteria have not yet been met, and accordingly, all development costs have been expensed.

#### **Stock-Based Compensation and Other Stock-Based Payments**

The Company applies a fair value based method of accounting for all stock-based payments. Accordingly, stock-based payments are measured at the fair value of the consideration received or the fair value of the equity instruments issued or liabilities incurred, whichever is more reliably measurable. Stock-based compensation is charged to operations over the vesting period and the offset is credited to contributed surplus. Consideration received upon the exercise of stock options is credited to share capital and the related contributed surplus is transferred to share capital.

#### **Share Issuance Costs**

Costs incurred in connection with the issuance of capital stock are netted against the proceeds received.

#### **Income Taxes**

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on temporary differences between financial reporting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

#### **Use of Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expenses during the year. Actual results could differ from those estimates. Significant areas requiring the use of management estimates relate to the determination of the useful lives of property and equipment

and patents for amortization purposes, valuation of ITC's receivable, valuation of stock options and warrants and valuation allowance on future tax assets.

## SELECTED FINANCIAL INFORMATION

The table below summarizes quarterly financial information for the 3 month periods shown. For periods prior to June 2007 the information is shown for umedik Inc., on a pro rata basis. For quarters ending prior to June 30, 2007 SQI Diagnostics Inc. was a private company. In 2007 SQI Diagnostics Inc. changed its year end from December 14 to September 30.

3 Month Periods Ending	March 31, 2008		June 30, 2008		September 30, 2008		December 31, 2008	
	Revenue	\$	19,145	\$	7,175	\$	19,025	\$
Net Loss	\$	521,274	\$	1,323,979	\$	926,404	\$	1,467,452
Net Loss Per Share	\$	(0.03)	\$	(0.06)	\$	(0.05)	\$	(0.07)
Weighted Average Shares		19,750,200		20,458,300		22,217,478		22,448,275

  

3 Month Periods Ending	March 31, 2007		June 30, 2007		September 30, 2007		December 31, 2007	
	Revenue	\$	31,140	\$	22,230	\$	17,190	\$
Net Loss	\$	739,450	\$	1,171,998	\$	946,214	\$	1,013,922
Net Loss Per Share	\$	(0.05)	\$	(0.07)	\$	(0.05)	\$	(0.05)
Weighted Average Shares		14,719,319		15,950,957		19,689,460		19,737,507

Revenue for the quarter ending December 31, 2008 was \$10,100 compared to \$44,493 for the quarter ending December 31, 2007. Reductions in revenue generation between the quarter ending December 31, 2008 and the quarter ending December 31, 2007 were due to a one-time partnership fee paid to the Company in December 2007 that did not re-occur in 2008 and a reduction in service-based revenue provided to a third party as the Company continues to focus its resources on its core development and commercialization efforts.

For the quarter ending December 31, 2008, the Company recorded a net loss of \$1,467,452 or \$0.07 per share, compared to the quarter ending December 31, 2007 of \$1,013,922 or \$0.05 per share. Per share values are based on the weighted average shares outstanding in the period. For the quarter ended December 31, 2008 there was a weighted average of 22,448,275 shares outstanding.

Net losses and net losses per share were greater for the quarter ending December 31, 2008 compared to the same period in 2007. The increased loss for the quarter ending December 31, 2008 was primarily related to increases in wage and wage-related expenses and consulting expenses. The primary contributors to the increased wages were an overall increase in R&D staffing from 23 to 28 persons and to a lesser extent to salary increases awarded to certain long-time employees. Other factors contributing to the higher net loss were new sales and marketing consulting expenses, refreshing the Company's website, creating new corporate branding, travel related to launching sales efforts in Canada, and an increase in stock-based compensation expenses.

R&D costs increased in the quarter ending December 31, 2008 by \$116,500 compared to the quarter ending December 31, 2007 from \$698,660 to \$815,152. The difference was related primarily to a \$43,000 increase in R&D salaries with the increase in staffing from 23 to 28 full-time R&D employees from December 2007 to 2008 and to costs (\$46,000) paid to third parties for

conducting validation tests for the QuantiSpot RA system and to regulatory consultants to assist the Company to prepare its regulatory filings. Increased laboratory consumables costs in the period ending December 31, 2008 compared to the quarter ending December 31, 2007 related to internal validation studies and discovery research on new tests under development and contributed to the increased R&D expenses. These were costs associated primarily with product commercialization and were new for the quarter ending December 31, 2009 compared to the year prior.

Corporate expenses include, primarily: all salaries and related expenses (including benefits and payroll taxes) of the Company other than salaries and related expenses paid to personnel engaged in research and development; facility costs; insurance costs; and foreign exchange expenses. Corporate expenses totaled \$241,027 for the quarter ending December 31, 2008 compared to \$157,195 for the quarter ending December 31, 2007. Corporate expenses increased by \$83,800. The major contributors to the increases between the periods was currency-related exchange loss timing differences, interest expenses related to the SR&ED receivable loan and expenses resulting from corporate re-branding and web design and re-launch. Owing to the growth in the organization the Company's variable occupancy costs (telecom, utilities, etc.) also contributed to the overall increase in corporate expenses in the quarter ending December 31, 2008 compared to the quarter ending December 31, 2007.

Professional consulting (legal, accounting, Board of Directors compensation, recruiting, sales and marketing and investor relations) costs in the quarter ending December 31, 2008 were \$206,867, an increase of \$142,575 compared to \$64,292 in the same quarter in 2007. The increase in the professional and consulting costs in the quarter ending December 31, 2008 were primarily related to non-recurring recruiting costs (\$51,100), to sales and marketing consulting fees and expenses (\$65,000) to prepare for the Company's North American product launch and to add a US-based sales leader who is engaged as a consultant to the Company but has no other outside obligations.

Operational expenses were partially offset by interest income earned on short-term investments of \$9,597 for the quarter ending December 31, 2008 compared to \$11,691 for the quarter ending December 31, 2007. The Company invests its cash in variable term cashable government investment certificates.

Non-cash stock based compensation charges totaled \$98,826 for the quarter ending December 31, 2008 compared to \$35,462 for the quarter ending December 31, 2007. The related stock option issuances are described further below in the Outstanding Share Capital section.

Management expects losses to continue for current fiscal year as investment continues in product development and commercialization efforts on its pipeline of autoimmune test kits as well as investment in sales and marketing with sales launches in Canada and the United States. Development and commercialization of at least 4 QuantiSpot test kits to the point of submitting data to the regulatory bodies is expected in calendar 2009 and this will generate increased expenses related to internal development, internal verification and validation studies and third party validation studies. It is Management's expectation that the R&D expenses reported in the period ending December 31, 2008 will continue to increase somewhat in fiscal 2009. Management expects some increases to R&D salary expenses as it adds technical resources and some senior science expertise to advance each of the products in the pipeline. It will also be necessary to invest in the operational elements in customer support and engineering to support our customers and as we place SQiDworks platforms across Canada and the United States. Management will plan to add these expenses as needed to support forecasted customer installations of SQiDworks platforms and sales of consumable kits. In general management does not expect a acceleration of administrative costs in the remainder of the fiscal year 2009. The Company's management will

continue to monitor the burn rate in relation to the capital available to it and will manage cash flows as required in the context of the capital markets. Management believes that it will, at some point, seek additional capital to advance and accelerate the number of tests under development, and as it meets expected milestones of successful development and regulatory approvals.

### **Related Party Transactions**

Transactions with related parties are incurred in the normal course of business and are measured at the exchange amount. Related party transactions are described listed below, unless they have been disclosed elsewhere in the financial statements.

Included in general and administrative expense for the quarter ended December 31, 2008 is \$10,603 (period ended December 31- \$10,348), related to recovery of occupancy costs, from a corporation in which an officer of the Company was also an officer. Consulting fee revenue of \$10,100 for the quarter ended December 31, 2008 (period ended December 31, 2007 - \$15,405) was earned from this corporation. At quarter end, December 31, 2008 an amount of \$1,727 (2007 - \$NIL) due from this corporation is included in amounts receivable.

### **Sources and Uses of Cash**

Operational activities for the quarter ending December 31, 2008 were financed by cash on hand. Cash reserves were increased in the period through the completion of the private placement closed December 23, 2008 wherein the Company sold 2,400,00 shares at a price of \$1.25 per share for cash proceeds of \$3,000,000. The exercise of 133,336 stock options resulted in proceeds of \$17,280.

At December 31, 2008, current assets were \$6,042,946 compared to \$4,362,230 at September 30, 2008. Working capital as at December 31, 2008 was \$4,929,995 compared to \$3,244,418 at September 30, 2008.

Subsequent to the year end, the Company completed a non-brokered private placement resulting in gross proceeds of \$1,664,375 through issuance of 1,331,500 common shares at \$1.25 per common share. The shares issued through the private placement are subject to a four month hold period.

Management believes that with the cash on hand at December 31, 2008, combined with that raised subsequent to the year-end will be sufficient to fund Company operations to the middle of 2010. The successful commercial launch and generation of revenue in the 2009 fiscal year would extend period.

### **Financial Instruments and Financing Risks**

The Company's SQiDworks automated analytical platform and its lead QuantiSpot RA test kit used to detect and quantify a panel of biomarkers to aid in the diagnosis of rheumatoid arthritis was licensed and cleared to be sold and marketed in Canada during the quarter ending December 31, 2008 and were authorized to be CE Marked and to be sold in Europe. During the quarter ending December 31, 2008, the Company filed a 510(k) Pre-market Notification with the United States Food & Drug Administration ("FDA") for review to seek approval to market and sell the QuantiSpot RA test kit and SQiDworks platform in the United States. Subsequent to the filing of the SQiDworks/QuantiSpot RA 510(k) the Company has begun the usual process of communication with the FDA about its applications and is optimistic that the filing will result in

approval of the 510(k) application.

QuantiSpot tests are designed to run only on the SQiDworks platform. In order to get the SQiDworks platform and QuantiSpot consumable tests approved for sale in the United States, the FDA typically requires the conduct of clinical validation studies to compare the performance of a new test to predicate tests currently approved for sale in the US. Upon successful completion of the validation studies the data derived is then presented to the FDA in the form of a 510(k) Pre-market Notification. It is typical for the external validation studies to take several months to complete and upon receipt of a completed 510(k) submission the FDA may take up to four months to render a decision on the application, not including any "time-outs" which the Company may take to prepare responses to various inquiries from the FDA.

The QuantiSpot APS multiplexed test panel used to detect and quantify a panel of biomarkers to aid in the diagnosis of APS, Crohn's disease, Celiac Disease and thyroid disease are currently in the Company's discovery and development pipeline. The Company is expecting one, or all of these new multiplexed test panels and the SQiDworks platform, together each a system, to be commercially ready to file applications with the applicable regulatory jurisdictions in 2009.

The Company has not earned revenues from its QuantiSpot test kits or SQiDworks platform. The Company expects to earn revenue from its platform and QuantiSpot RA product in 2009. The Company does not expect the revenues generated from initial sales of platforms and QuantiSpot RA test kits to exceed its operating expenses in the 2009 fiscal year. The continuation of the Company's research, development and commercialization activities along with investment in marketing and sales is dependent upon the Company's ability to successfully manage its growth, investment in continued pipeline development and its cash requirements. Management believes that it has sufficient cash reserves to support product launches of QuantiSpot RA and SQiDworks in North America and to complete development work, validation studies and regulatory efforts required for its current pipeline of up to 4 new QuantiSpot test panels.

We are exposed to market risks related to changes in interest rates and foreign currency exchange rates, which could affect the value of our current assets and liabilities. We do not believe that the results of operations or cash flows would be affected to any significant degree by a sudden change in market interest rates relative to our cash investment, due to the prime interest rate based nature of the investment. We have not entered into any forward currency contracts or other financial derivatives to hedge foreign exchange risk. We are subject to foreign exchange rate changes that could have a material effect on future operating results or cash flows.

Management will continue to review the Company's financial needs and to seek additional capital financing as required from sources that may include equity financing, debt financing, collaborative projects and licensing arrangements. However, there can be no assurance that such additional funding will be available or if available, whether acceptable terms will be offered.

### **Outstanding Share Capital**

As at December 31, 2008, there were 24,750,814 common shares issued and outstanding.

The following tables describe the securities that have been issued that are convertible under certain conditions into common shares:

The Company had the following warrants outstanding at December 31, 2008:

<b>Number of Warrants</b>	<b>Purchase Price</b>	<b>Expiry Date</b>
83,335	\$ 0.440	April 26, 2009
20,834	\$ 1.200	April 26, 2009
344,004	\$ 1.200	April 26, 2009
285,404	\$ 1.600	June 29, 2009
1,783,776	\$ 2.400	June 29, 2009
1,076,867	\$ 0.600	April 26, 2010
194,200	\$ 1.500	June 3, 2010
236,800	\$ 1.900	December 23, 2011
<b>4,025,220</b>		

The Company had the following stock options outstanding under the Plan at December 31, 2008:

<b>Number of Options</b>	<b>Exercise Price</b>	<b>Expiry Date</b>
8,334	\$ 1.680	July 1, 2009
833,350	\$ 0.600	April 15, 2010
141,670	\$ 1.200	April 15, 2010
88,892	\$ 1.200	June 29, 2011
83,335	\$ 1.200	August 29, 2011
197,500	\$ 1.740	August 7, 2012
50,000	\$ 1.500	October 23, 2012
757,500	\$ 1.600	February 15, 2013
302,500	\$ 1.750	August 26, 2013
<b>2,463,079</b>		

The Company also had 133,333 options outstanding at December 31, 2008 that were not granted under the plan. All of these options were exercisable at September 30, 2008 and have an exercise price of \$0.90 and expire on October 14, 2009.

### **Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

### **Adoption of New Accounting Policies**

Effective October 1, 2007, the Company adopted the recommendations of the CICA Handbook Section 1535, Capital Disclosures. Handbook Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The Company has included disclosures recommended by the new Handbook section in Note 17 to the consolidated financial statements.

Effective October 1, 2007, the Company adopted the new recommendations of the CICA Handbook Section 1506, Accounting Changes. Under these new recommendations, voluntary changes in accounting policy are permitted only when they result in the financial statements providing reliable and more relevant information, require changes in accounting policy to be applied retrospectively unless doing so is impractical, require prior period errors to be corrected

retrospectively or require enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. These recommendations also require the disclosure of new primary sources of generally accepted accounting principles that have been issued but not yet effective. The impact that the adoption of this section will have on the Company's financial statements will depend on the nature of future accounting changes and the required additional disclosure on Recent Accounting Pronouncements is disclosed in Note 4 to the consolidated financial statements.

Effective October 1, 2007, the Company adopted the recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosure. Section 3862 provides standards for disclosures about financial instruments, including disclosures about fair value and the credit, liquidity and market risks associated with the financial instruments. Disclosure requirements pertaining to Section 3862 are contained in Note 18 to the consolidated financial statements.

Effective October 1, 2007, the Company adopted the recommendations of CICA Handbook Section 3863, Financial Instruments - Presentation. Section 3863 provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the presentation of the Company's financial instruments.

## **FUTURE PROSPECTS**

In its current state of evolution, management believes that the Company has assembled the appropriate intellectual, financial, and human capital to advance its current pipeline of autoimmune test panels and SQiDworks system through the completion of clinical validation studies and regulatory filings in Canada, the U.S. and Europe. The Company believes that completion and approval, in Canada, of its lead assay and authorization to CE Mark it in Europe justifies intensified investment in development and commercialization of its pipeline of an additional group of at least nine other autoimmune microarray diagnostic panels. It further believes that successful completion of these pipeline tests may lead to the development and commercialization of other test panels addressing unmet medical needs in the detection of known analytes used in the diagnosis of infectious disease and allergy management. At present, the Company's value proposition is derived from the successful completion of internal validation studies; its Health Canada approval CE Marking and its expected successful marketing clearance by the FDA; and, the potential value in its product development pipeline and further future enhancements of its automated microarray processing platform. The Company's platform and tests are expected to replace highly manual and semi-automated test methodologies with a fully automated, multiplexed solution and to provide significant cost savings to its customers. The Company believes that the market size related to the testing of patients in its primary markets in Canada, the U.S. and Europe is significantly large and the Company's value proposition to its customers will provide opportunities for significant revenues from the sale of commercial assays and test platforms in each of its target markets.

SQI's operational objectives are straightforward: adequate and complete response to any communication received from regulatory bodies in connection with the QuantiSpot multiplexed tests and the SQiDworks platform; continued successful commercialization of a menu of autoimmune test kits; and, focus on customer acquisition and revenue in the regulatory jurisdictions for which we have acquired approvals or licenses. Success in these steps will allow the Company to validate its multiplexing model, value proposition and to roll-out and sell its products to customers in its target markets.

During 2009, the Company plans to execute on the following components of its operational strategy:

- Generate, maintain and grow customer sales in North America;
- Complete commercialization and regulatory filings for a pipeline of autoimmune products;
- Work with our partners to enhance our product offerings;
- Provide world-class customer support and service to ensure satisfaction; and,
- Publish scientific papers to broaden our product value proposition.

The Company will continue to invest in research and development activities related to its core platform technologies of microarray-based assays and detection devices.

## **DISCLOSURE CONTROLS AND PROCEDURES, AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

The accompanying financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. For quarterly reporting periods, the Company's financial statements are approved by the Audit Committee and the Board of Directors. For annual reporting periods, the Company's financial statements are approved by the Board of Directors upon recommendation by the Audit Committee. The integrity and objectivity of these financial statements are the responsibility of management. In addition, management is responsible for all other information in this report and for ensuring that this information is consistent, where appropriate, with the information contained in the financial statements.

In support of this responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

In particular, the CEO and CFO are responsible for establishing and maintaining disclosure controls and procedures ("DC&Ps") and internal controls over financial reporting ("ICFRs") for the Company, and have:

- (a) designed such DC&Ps, or caused them to be designed under supervision, to provide reasonable assurance that material information is made known during the period in which the annual and quarterly filings are being prepared;
- (b) designed such ICFRs, or caused them to be designed under supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP;
- (c) evaluated the design and effectiveness of the Company's DC&Ps as of the quarter ending December 31, 2008;
- (d) have concluded that a material design weakness in the ICFRs may exist in terms of the inadequate segregation of certain duties, which is typical of development stage companies; mitigating factors, including dual-payment authorization policies and transparent internal financial transaction reporting processes, serve to minimize the risk that such design weakness could result in a material misstatement of results for the quarter ending December 31, 2008; and
- (e) have concluded that, other than the item described above in sub-point

(d), there are no additional material design weaknesses in the DC&Ps or ICFRs, and that the effectiveness of the DC&Ps is sufficient to expect the prevention or detection of material misstatements of results.

The financial statements include amounts that are based on the best estimates and judgments of management. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board of Directors exercises this responsibility principally through the Audit Committee. The Audit Committee consists of three directors, all of whom are independent and not involved in the daily operations of the Company. The Audit Committee meets with management and the external auditors to satisfy itself that management's responsibilities are properly discharged and to review the financial statements prior to their presentation to the Board of Directors for approval.