

# **SQI Diagnostics Inc.**

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

**December 31, 2009**

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

*This discussion and analysis covers the audited financial statements for the quarter ended December 31, 2009 and 2008, 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 dollar amounts are thousands of Canadian dollars and all share amounts are thousands unless otherwise noted.*

*This discussion and analysis was performed by management using information available as at February 24, 2010. 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, obtaining regulatory approvals, successful product development, 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 from them. 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 clearance from the United States Food & Drug Administration ("FDA"), Canadian regulatory approval for, and has CE Marked its SQiDworks™ platform together with its IgXPLEX RA™ test kits used to detect and measure a panel of biomarkers to aid in the diagnosis of rheumatoid arthritis. The Company has also received Canadian regulatory approval for, and has CE marked its fully quantitative QuantiSpot RA™ tests kits, run on the SQiDworks platforms. The QuantiSpot RA test kits provide fully quantitative information to further aid in the diagnosis and diagnostic monitoring of rheumatoid arthritis. The Company is developing and commercializing other test kits for the autoimmune disease market as described further below, 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 then in Europe following the successful commercialization of several additional IgXPLEX test panels.

The Company's proprietary SQiDworks instrument and consumable tests together form 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 and semi-automated, microarray-based test platforms enabling laboratory customers to generate multiple patient results with one unit of 'test effort'.
- (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 qualitative IgXPLEX RA and quantitative QuantiSpot RA multiplex panels 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 celiac disease, vasculitis, lupus, Crohn's disease, and antiphospholipid syndrome (APS). Other autoimmune disease, infectious disease and allergen panels are expected to follow. The Company believes that the approved IgXPLEX RA and QuantiSpot RA tests have provided a template for the rapid development and commercialization of subsequent autoimmune panels. The majority of the development efforts for each subsequent assay panel and the SQiDworks system rely heavily on the infrastructure of the prior assay and this infrastructure does not require additional development.
- (c) The Company has also completed proof of concept for a test to measure the presence of biologic drugs used to treat a variety of autoimmune diseases. The Company believes that a test to measure these molecules in patients will provide important clinical and treatment management tools for autoimmune diseases. During the period the Company completed development of the prototype of this test and subsequent to the period end provided its partner with the IgXPLEX IA (infiximab assay) to enable it to perform validation studies. The Company has previously referred to this development product as anti-TNF. The Company believes that it will deliver a commercial product to its partner by the end of the second fiscal quarter. Following validation and commercial delivery the Company and its partner will launch the commercial roll-out of the IgXPLEX IA .
- (d) The Company has completed the discovery phase milestones under contract for a panel to detect multiple analytes used to aid in the detection and diagnosis of botulism infection in partnership with Silliker Inc., a subsidiary of bioMérieux sa. Subsequent to the period end the Company was completing negotiations of a development and supply agreement wherein it is contemplated that the Company will complete commercialization of the IgXPLEX BotX™ panel and deliver this to Silliker Inc. in the 2010 calendar year.

From 2003 to present, the Company has been primarily involved in research, development and initial 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. During the fiscal period ending December 31, 2009 the Company invested in its sales and marketing team, science commercialization and regulatory groups and infrastructure. The sales effort is focusing on the North American market to generate sales with the currently approved system including the SQiDworks fully automated analytical platform, IgXplex RA panel and QuantiSpot RA panel. The science commercialization and regulatory groups are focusing on the continued development of pipeline assays and SQiDworks platform.

## Commercial Development Current Status

During the quarter ended December 31, 2009, the Company obtained clearance from the FDA to market and sell the IgXPLEX RA and SQiDworks system; the first ever cleared multiplexed/microarray product. Health Canada licenses were also obtained to market the IgXPLEX RA product in addition to the previously licensed QuantiSpot RA product and SQiDworks platform. The information below provides an overview of the Company's achievements during the quarter ended December 31, 2009:

- Received United States FDA 510(k) Pre-Market clearance for the SQiDworks Platform and IgXPLEX RA kit, together a system
- Submitted application and received Health Canada license for the SQiDworks Platform and IgXPLEX RA kit to align our Canadian and US RA product offerings;
- Obtained the patent "Method to Measure Dynamic Internal Calibration True Dose Response Curves". Management believes this patent to be a significant achievement in its intellectual property portfolio and is critical to the protection of in-array calibration and normalization.
- Progressed a number of pipeline diagnostic tests through our discovery and development program.
  - Celiac 4-plex panel completed development and is awaiting validation.
  - Vasculitis entered into the proof of concept process and is expected to advance to development verification stage by the end of the second fiscal quarter of 2010.
  - IgXplex IA was transferred to our partner for their internal validation studies. The successful internal validation of the IgXplex IA product would result in commercialization of a research use only (RUO) product and initial release by the end of the second fiscal quarter of 2010.

During the quarter ending December 31, 2009 and in the first calendar quarter of 2010, the Company entered into an evaluation agreement and installed a SQiDworks platform at a major Canadian reference laboratory on a consignment basis. Under the terms of the evaluation agreement, the customer will have 90 days to evaluate the performance of the SQiDworks system for aiding in the diagnosis of rheumatoid arthritis. Upon completion of the evaluation, the customer has the option to retain the SQiDworks platform for commercial use in its reference laboratory and to purchase IgXplex consumables as required to meet its commercial needs.

## Corporate Financing Transactions

On December 04, 2009, the Company completed a private placement resulting in the issuance of 2,398,000 shares at a price of \$2.75 per share for gross proceeds of \$6,595,000 (net of costs - \$6,162,000). Each unit is comprised of one common share and one-half common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at a price of \$4.00, expiring December 4, 2011. The total share issuance costs were \$628,000.

A total of 9,000 options were exercised at a price of \$2.40 per common shares for gross proceeds

of \$22,000 in November 2009.

A total of 33,000 warrants were exercised for gross proceeds of \$30,000 in November 2009.

### **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 Company's ability to successfully commercialize additional IgXPLEX™ tests in the autoimmune disease market;
- 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 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 and Trademarks**

The costs relating to patent and trademark fees are deferred and amortized over 10 years on a straight-line basis. Patents and trademarks are recorded net of accumulated amortization of \$429,000 (September 30, 2009 - \$393,000).

## **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, 2009, 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, at which time 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 and trademarks for amortization purposes, valuation of ITCs receivable, valuation of stock options and warrants and valuation allowance on future tax assets.

## SELECTED FINANCIAL INFORMATION

### First Quarter Commentary

The table below summarizes quarterly financial information for the 3 month periods shown.

	March 31, 2009 (000s)	June 30, 2009 (000s)	September 30, 2009 (000s)	December 31, 2009 (000s)
<b>Revenue</b>	\$ 7	\$ 8	\$ 7	\$ 5
<b>Net Loss</b>	\$ 1,473	\$ 1,354	\$ 1,387	\$ 1,620
<b>Net Loss Per Share</b>	\$ (0.06)	\$ (0.05)	\$ (0.06)	\$ (0.06)
<b>Weighted Average Shares</b>	\$ 25,837	\$ 26,326	\$ 25,158	\$ 27,930

	March 31, 2008 (000s)	June 30, 2008 (000s)	September 30, 2008 (000s)	December 31, 2008 (000s)
<b>Revenue</b>	\$ 19	\$ 7	\$ 19	\$ 10
<b>Net Loss</b>	\$ 521	\$ 1,324	\$ 926	\$ 1,467
<b>Net Loss Per Share</b>	\$ (0.03)	\$ (0.06)	\$ (0.05)	\$ (0.07)
<b>Weighted Average Shares</b>	\$ 19,750	\$ 20,458	\$ 22,217	\$ 22,448

Revenue for the quarter ended December 31, 2009 was \$5,000 compared to \$10,000 for the quarter ended December 31, 2008. Revenue for the three month periods ending December 31, 2009 and 2008 was from services provided to a third party.

For the quarter ended December 31, 2009, the Company recorded a net loss of \$1,620,000 (\$0.06 net loss per share) compared to a net loss of \$1,467,000 (\$0.07 net loss per share) for the quarter ended December 31, 2008. Per share values are based on the weighted average shares outstanding in the period. For the quarter ended December 31, 2009 there was an average of 27,930,000 shares outstanding.

The net loss was greater for the quarter ended December 31, 2009 compared to December 31, 2008. The increased loss for the three months ending December 31, 2009 was primarily related to increased activity and expenses in the discovery efforts for and development of several IgXplex assays, including ordinary increases in wage and wage-related expenses owing to an increase in personnel and consulting expenses. Consulting expenses were higher in the quarter ending

December 31, 2009 owing to the addition of contract resources in sales and marketing, and various operational resources not directly involved in research and development. The loss per share for the quarter ended December 31, 2009 was lower than that for the prior year due to the increase in the number of shares outstanding.

R&D expenditures for the three month period ended December 31, 2009 were \$978,000 and compared to the \$815,000 for the three month period ended December 31, 2008. The increase in R&D expense for the three month period ended December 31, 2009 compared to the three months ending December 31, 2008 related primarily to increased laboratory consumable costs and laboratory operating expenses due to the increased R&D activity. During the quarter ending December 31, 2009 there were an increased number of assay panels in discovery and development including Celiac, Vasculitis, Crohn's disease and IgXplex IA compared to the same period in the previous year when the majority of efforts were related to only the rheumatoid arthritis panel and related SQiDworks-IgXPLEX technology. In addition, there was an increase in regular R&D salary expenses and an increase in the number of R&D employees compared to same quarter in the previous year.

Salaries and wages increased from \$105,000 in the quarter ending December 31, 2008 to \$124,000 for the quarter ending December 31, 2009 owing primarily to contractual increases in administrative salaries paid in 2009.

General and administrative expenses include: facility costs; insurance costs; and foreign exchange expenses. Corporate expenses totalled \$94,000 for the quarter ended December 31, 2009 compared to \$120,000 for the quarter ended December 31, 2008. The decrease from the quarter ended December 31, 2009 compared to the same period in 2008 was primarily a result of lower currency exchange and marketing costs.

Professional consulting (legal, accounting, Board of Directors compensation, recruiting, sales and marketing, administrative contractor, and investor relations) costs in the quarter ended December 31, 2009 were \$252,000 compared to \$207,000 from the quarter ended December 31, 2008. The increase in the professional and consulting costs in the quarter ended December 31, 2009 were primarily related to sales and marketing consultant's fees with an increase in the number of sales consultants utilized and to sales activity-related travel expenses. The largest contributor to consultant's fees was the Company's addition of US-based sales and marketing resources in September 2008, and a US-based customer sales engineer was added in April, 2009. During the quarter ended December 31, 2009 the Company incurred additional consulting expenses compared to the quarter ended December 31, 2008 as it utilized multiple experts in the areas of software testing, laboratory cost analysis and work-flow management.

Operational expenses were partially offset by interest income earned on short-term investments of \$3,000 for the quarter ended December 31, 2009 compared to \$10,000 for the quarter ended December 31, 2008. The Company invests its cash in variable term cashable government investment certificates and short-term money market deposits.

Non-cash stock based compensation charges totalled \$49,000 for the quarter ended December 31, 2009 (\$99,000 - year ended December 31, 2009). The related stock option issuances are described further below in the Outstanding Share Capital section.

## **Outlook**

Management expects losses to continue for the 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. During the quarter ending December 30, 2009 the Company initiated its US sales efforts following the receipt of clearance from the FDA for its SQiDworks-IgXplex RA™ system in November 2009. During the 2010 fiscal year the Company plans to focus on sales and placing SQiDworks systems in US-based customers for system evaluation and expects that some of these evaluation placements will lead to commercial acceptance and revenues from sales of consumables. The Company delivered one such evaluation placement in January 2010 to a Canadian reference laboratory. This system was installed and validated by the SQI team and handed off to the customer in February following training of its operational personnel. The customer has 90 days to run its internal acceptance validation.

During the fourth quarter of the 2009 fiscal year and the first quarter of the 2010 fiscal year, the Company generated significant customer feedback relating to the commercial feasibility of its system and consumable tests. Based on this market feedback, the Company believes that its strategy of focusing development, commercialization and marketing efforts on panels of autoimmune assays and targeted at medium and large reference laboratory customers continues to be sound. The Company has utilized the feedback from potential customers to validate the order and prioritization of its pipeline of products to optimize the revenue potential of the platform. Our analysis of the market would indicate that there are over 300 laboratories in the United States with sufficient volume of rheumatoid arthritis testing to be target customers for the SQiDworks / IgXplex RA system. While not all of these target customers will wish to adopt our technology management believes that the addressable market is sufficiently large and that with the completion of additional IgXplex panels the company will be well-positioned for commercial acceptance in 2010.

Based on its successful FDA clearance, its Health Canada licenses and EU authorization, management has increased the intensity of the development and commercialization of several new IgXplex test kits and expects this development to result in the submission of applications to the US, Canadian and EU regulatory bodies in fiscal 2010. This activity will generate increased expenses related to internal development, internal verification and validation studies and third party validation studies in the 2010 fiscal year. By the end of March 2010, the Company expects, by the end of March 2010 to offer a prototype research use only version of an anti-infliximab test kit (IgXplex IA) to be used in the management of autoimmune disease. It is management's expectation that the R&D expenses reported in the year ended September 30, 2009 will increase in the 2010 fiscal year. Management expects increases to R&D salary expenses, lab expenses and clinical validation study expenses and patient blood sample acquisition costs as it increases the number of IgXplex multiplex assays that are moved from development and into third party validation studies. Each successful validation is expected to result in the filing of applications to clear these assays with the FDA and to seek regulatory approvals in Canada and the EU.

It will also be necessary to invest in the customer service and administrative elements to support our customers and sales, 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 expects an increase in administrative costs during the 2010 fiscal year. Management will continue to monitor the cash 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 may, at some point, seek additional capital to advance and accelerate the number of tests under development and being validated for regulatory submissions as well as to expand our sales team and its efforts in the United States.

## Sources and Uses of Cash

Operational activities for the quarter ended December 31, 2009 were financed by cash on hand.

During the quarter ended December 31, 2009:

1. A total 9,000 Options were exercised at a price of \$2.40 per common shares for gross proceeds of \$22,000 in November 2009.
2. A total of 33,000 warrants were exercised for gross proceeds of \$30,000 in November 2009.
3. On December 04, 2009, the Company completed a private placement resulting in the issuance of 2,398,000 units for gross proceeds of \$6,595,000 (net of costs - \$6,162,000). Each unit is comprised of one common share and one-half common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at a price of \$4.00, expiring December 4, 2011. The total share issuance costs were \$566,000.

At December 31, 2009, current assets were \$8,543,000 compared to \$3,649,000 at September 30, 2009. Working capital as at December 31, 2009 was \$7,916,000 compared to \$3,280,000 at September 30, 2009.

Management believes that cash on hand at December 31, 2009 will be sufficient to fund Company operations for at least 12 months. A successful commercial launch and generation of forecasted revenue in the 2010 and 2011 fiscal years would extend this period.

## Risks

The Company's SQiDworks automated analytical platform and its lead IgXplex RA test kit used to detect and quantify a panel of biomarkers to aid in the diagnosis of rheumatoid arthritis was cleared and licensed to be sold and marketed in Canada during the quarter ended December 31, 2008 and in the United States in November of 2009, and in the quarter ended March 31, 2009 were authorized to be CE Marked and to be sold in Europe.

IgXplex and QuantiSpot tests are designed to run only on the SQiDworks platform. In order to obtain approval for the SQiDworks platform and the Company's consumable tests for sale in the United States, our largest target market, 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 validation studies conducted at both SQI's labs and at multiple third party labs, 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 180 days 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 Company believes the experience gained in obtaining the clearance of the SQiDworks- IgXPLEX RA system will enable it to complete and file applications for clearance of subsequently developed pipeline IgXPLEX assays more efficiently. This in turn may result in shorter review periods at the FDA than was experienced with the SQiDworks-IgXPLEX RA system. The timing of such clearances is dependent on several factors some of which are not controlled by the Company.

The IgXPLEX multiplexed test panels used to detect and quantify a panel of biomarkers to aid in

the diagnosis of celiac disease, vasculitis, lupus, and Crohn's disease, are currently in the Company's discovery and development pipeline as well as the IgXPLEX IA panel to detect the drug, infliximab, that is used in the management of multiple autoimmune diseases. The IgXPLEX IA panel is used to measure the quantity of therapeutic agent in the body and the information from this test could be used by clinicians in the management of several autoimmune diseases, including rheumatoid arthritis and irritable bowel disease. The Company is expecting one, or all of these new multiplexed test panels, excepting IgXPLEX IA, and the SQiDworks platform, together each a system, to be commercially ready to file applications with the applicable regulatory jurisdictions in calendar 2010. The IgXPLEX IA will be available for commercial sale for research use prior to any regulatory filings being submitted, but following validation at customer labs.

The Company has not earned material revenues from its test kits or SQiDworks platform. The Company expects to earn revenue from its platform and IgXPLEX RA product commencing in fiscal 2010. 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 IgXPLEX 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 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, 2009, there were 29,633,000 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, 2009:

<b>Number of Warrants</b> (000s)	<b>Purchase Price</b>	<b>Expiry Date</b>
199	\$ 0.60	26-Apr-10
194	\$ 1.50	03-Jun-10
1,775	\$ 2.40	29-Jun-10
237	\$ 1.90	23-Dec-11
107	\$ 1.25	22-Jan-11
1,199	\$ 4.00	04-Dec-11
144	\$ 2.75	04-Dec-11
<b>3,865</b>		

The Company had the following stock options outstanding under the Plan at December 31, 2009:

<b>Number of Options</b> (000s)	<b>Exercise Price</b>	<b>Expiry Date</b>
658	\$ 0.60	15-Apr-10
142	\$ 1.20	15-Apr-10
89	\$ 1.20	29-Jun-11
83	\$ 1.20	29-Aug-11
198	\$ 1.74	07-Aug-12
50	\$ 1.50	23-Oct-12
758	\$ 1.60	26-Feb-13
303	\$ 1.75	26-Aug-13
80	\$ 1.30	22-May-14
25	\$ 3.26	03-Nov-14
<b>2,385</b>		

The Company also has 33,000 options outstanding at December 31, 2009 that were not granted under the Plan. All of these options were exercisable at December 31, 2009 and have an exercise price of \$0.90 and expired on January 13, 2010. These options were exercised subsequent to the quarter end.

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

The Company has no off-balance sheet arrangements.

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

Effective October 1, 2008, the Company adopted Handbook Section 3031, which prescribes the measurement of inventories at the lower of cost and net realizable value, with guidance on the determination of cost including allocation of overheads and other costs to inventory. Reversals of previous write-downs to net realizable value are permitted when there is a subsequent increase in the value of inventories. The Company has determined that the implementation of this new standard had no impact on the Company's financial statements.

Effective October 1, 2008, the Company adopted Handbook Section 3064, Goodwill and Intangible Assets. Section 3064, which replaces Section 3062, Goodwill and Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Adoption of this standard had no impact on the presentation of the Company's financial statements.

### **Recent Accounting Pronouncement Issued and Not Yet Applied**

In January 2009, the CICA issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. In addition, the CICA issued Sections 1601, Consolidated Financial Statements, and 1602, Non-Controlling Interests, which replaces the existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements, while section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination.

These standards apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The Company does not believe there to be any potential impact on its consolidated financial statements.

The CICA plans to converge Canadian Generally Accepted Accounting Principles with International Financial Reporting Standards ("IFRS") over a transition period expected to end in 2011, when IFRS will be fully adopted. The transition date of October 1, 2010 for the Company will require restatement for comparative purposes of amounts reported by the Company for the year ended September 30, 2011. While the company has begun assessing the adoption of IFRS for 2012, the financial reporting impact of the transition to IFRS has not been determined at this time.

### **Future Prospects**

In its current state of evolution, management believes that the Company has assembled the necessary intellectual, financial, and human capital to advance its current pipeline of autoimmune test panels and the SQiDworks system through the completion of clinical validation studies and regulatory filings in Canada, the U.S. and Europe. The Company believes that completion of its lead assay and clearance in the United States, licensing in Canada, 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 autoimmune microarray diagnostic panels over the next two years with four of these currently in the Company's discovery and development process. 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 its FDA clearance, Health Canada approval and CE Marking for IgXPLEX RA and QuantiSpot RA and SQiDworks platform; the acquisition of potential customers following their successful internal validation of the system; the potential value in its product development pipeline; and, further future enhancements of its automated microarray processing platform. The Company's platforms 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 sufficiently 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: commercial exploitation and revenue from products in the regulatory jurisdictions for which we have acquired regulatory approvals or licenses; continued successful commercialization and continuous improvement of a menu of autoimmune test kits; and expansion of partnerships and other strategic relationships to enhance our product offerings or revenues. Success in these steps will allow the Company to further validate its multiplexing model, value proposition and to roll-out and sell its products to customers in its target markets.

During the fiscal 2010 year, 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, celiac, vasculitis, lupus, Crohn's and anti-infliximab 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 ended December 31, 2009;

(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 ended December 3, 2009; 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.