

**CANNASAT THERAPEUTICS INC.  
FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007**

**Audited**

**CANNASAT THERAPEUTICS INC.**  
**December 31, 2008 and 2007**

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McGovern, Hurley, Cunningham, LLP  
Chartered Accountants

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**AUDITORS' REPORT**

To the Shareholders of  
**CANNASAT THERAPEUTICS INC.**

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

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

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

**McGOVERN, HURLEY, CUNNINGHAM, LLP**

A handwritten signature in cursive script that reads 'McGovern, Hurley, Cunningham, LLP'.

**Chartered Accountants  
Licensed Public Accountants**

TORONTO, Canada  
March 9, 2009  
except for Note 13  
which is at March 31, 2009

**CANNASAT THERAPEUTICS INC.**  
**Balance Sheets**  
**As at December 31,**

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|                                           | 2008         | 2007         |
|-------------------------------------------|--------------|--------------|
| <b>ASSETS</b>                             |              |              |
| <b>CURRENT</b>                            |              |              |
| Cash and cash equivalents                 | \$ 805,128   | \$ 787,469   |
| Sundry receivables (Note 9)               | 53,636       | 70,893       |
|                                           | 858,764      | 858,362      |
| EQUIPMENT (Note 4)                        | 7,200        | 7,593        |
| LONG-TERM INVESTMENT (Note 5)             | -            | 887,690      |
| DEFERRED COMPENSATION EXPENSE (Note 6(c)) | 16,000       | 112,000      |
| OTHER INTANGIBLE ASSETS (Note 7)          | 200,000      | 200,000      |
|                                           | \$ 1,081,964 | \$ 2,065,645 |

**LIABILITIES**

|                                                           |            |            |
|-----------------------------------------------------------|------------|------------|
| <b>CURRENT</b>                                            |            |            |
| Accounts payable and accrued liabilities (Notes 9 and 11) | \$ 513,254 | \$ 370,446 |
| Current portion of notes payable (Note 8)                 | 100,000    | 100,000    |
|                                                           | 613,254    | 470,446    |

COMMITMENTS AND CONTINGENCIES (Note 11)  
GOING CONCERN (Note 2)

**SHAREHOLDERS' EQUITY**

|                                 |              |              |
|---------------------------------|--------------|--------------|
| SHARE CAPITAL (Note 6(b))       | 8,241,900    | 7,805,573    |
| CONTRIBUTED SURPLUS (Note 6(e)) | 1,538,126    | 1,108,927    |
| DEFICIT (Note 6(e))             | (9,311,316)  | (7,319,301)  |
|                                 | 468,710      | 1,595,199    |
|                                 | \$ 1,081,964 | \$ 2,065,645 |

APPROVED BY THE BOARD:

“Peter Palframan”, Director

“Rochelle Stenzler”, Director

The accompanying notes are an integral part of these Financial Statements

**CANNASAT THERAPEUTICS INC.**  
**Statements of Operations and Deficit**  
**For the years ended December 31,**

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|                                                         | 2008           | 2007           |
|---------------------------------------------------------|----------------|----------------|
| REVENUE                                                 |                |                |
| Interest income                                         | \$ 16,708      | \$ 71,060      |
| EXPENSES                                                |                |                |
| General and administrative                              | 1,114,771      | 954,956        |
| Research and development                                | 889,600        | 1,023,423      |
| Amortization of equipment                               | 2,060          | 2,270          |
| Stock option compensation expense                       | 261,056        | 265,985        |
| Recovery on scientific research                         | (26,454)       | (39,460)       |
|                                                         | 2,241,033      | 2,207,174      |
| LOSS BEFORE THE UNDERNOTED                              | (2,224,325)    | (2,136,114)    |
| GAIN ON SALE OF EQUITY ACCOUNTED<br>INVESTMENT (Note 5) | 254,936        | -              |
| LOSS FROM EQUITY ACCOUNTED<br>INVESTMENT (Note 5)       | (22,626)       | (96,662)       |
| NET LOSS FOR THE YEAR                                   | (1,992,015)    | (2,232,776)    |
| DEFICIT, BEGINNING OF YEAR (Note 6(e))                  | (7,319,301)    | (5,086,525)    |
| DEFICIT, END OF YEAR                                    | \$ (9,311,316) | \$ (7,319,301) |
| LOSS PER SHARE - basic and diluted                      | \$ (0.03)      | \$ (0.03)      |
| WEIGHTED AVERAGE NUMBER OF<br>SHARES OUTSTANDING        | 73,199,610     | 68,784,541     |

The accompanying notes are an integral part of these Financial Statements

**CANNASAT THERAPEUTICS INC.**  
**Statements of Cash Flows**  
**For the years ended December 31,**

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|                                                                         | 2008              | 2007              |
|-------------------------------------------------------------------------|-------------------|-------------------|
| <b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b> |                   |                   |
| <b>OPERATING</b>                                                        |                   |                   |
| Net loss for the year                                                   | \$ (1,992,015)    | \$ (2,232,776)    |
| Items not affecting cash                                                |                   |                   |
| (Gain) on sale of equity accounted investment                           | (254,936)         | -                 |
| Loss from equity accounted investment                                   | 22,626            | 96,662            |
| Amortization of equipment                                               | 2,060             | 2,270             |
| Value of shares issued for services                                     | 25,000            | -                 |
| Stock option compensation expense                                       | 261,056           | 265,985           |
|                                                                         | (1,936,209)       | (1,867,859)       |
| Changes in non-cash operating working capital items                     |                   |                   |
| Sundry receivables                                                      | 17,257            | 210,945           |
| Accounts payable and accrued liabilities                                | 142,807           | (40,270)          |
|                                                                         | (1,776,145)       | (1,697,184)       |
| <b>INVESTING</b>                                                        |                   |                   |
| Proceeds from loan receivable (Note 5)                                  | -                 | 480,000           |
| Proceeds from sale of long-term investment (Note 5)                     | 1,120,000         | -                 |
| Acquisition of equipment                                                | (1,666)           | -                 |
|                                                                         | 1,118,334         | 480,000           |
| <b>FINANCING</b>                                                        |                   |                   |
| Exercise of stock options                                               | -                 | 19,500            |
| Private placements, net of issue costs                                  | 675,470           | 774,790           |
|                                                                         | 675,470           | 794,290           |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>             | <b>17,659</b>     | <b>(422,894)</b>  |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>                     | <b>787,469</b>    | <b>1,210,363</b>  |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>                           | <b>\$ 805,128</b> | <b>\$ 787,469</b> |
| <b>CASH AND CASH EQUIVALENTS CONSIST OF</b>                             |                   |                   |
| Cash                                                                    | 167,474           | 189,678           |
| Cash equivalents                                                        | 637,654           | 597,791           |
|                                                                         | \$ 805,128        | \$ 787,469        |

SUPPLEMENTARY CASH FLOW INFORMATION (Note 12)

The accompanying notes are an integral part of these Financial Statements

# CANNASAT THERAPEUTICS INC.

## Notes to the Financial Statements

### December 31, 2008 and 2007

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#### 1. DESCRIPTION OF BUSINESS

Cannasat Therapeutics Inc. (the “Company” or “Cannasat”) is a publicly traded (CTH: TSXV) clinical stage pharmaceutical company developing products to treat neuropathic pain, schizophrenia and other neurological conditions. Cannasat Pharmaceuticals Inc. was incorporated under the Canada Business Corporations Act on January 16, 2004 and changed its name from Cannasat Pharmaceuticals Inc. to Cannasat Therapeutics Inc. on January 25, 2005. Cannasat and Lonsdale Public Ventures Inc. (“Lonsdale”), a capital pool company, were amalgamated on March 15, 2006 under the Business Corporations Act (Canada) and continued as one company with the name “Cannasat Therapeutics Inc.”

#### 2. ACCOUNTING POLICIES AND GOING CONCERN

These financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles and their basis of application is consistent with that of the previous year. Outlined below are those policies considered to be particularly significant:

##### *Going Concern*

While the financial statements have been prepared on the basis of accounting principles applicable to a going concern, several adverse conditions and events cast substantial doubt upon the validity of this assumption. The Company has used cash of \$7,156,933 in operating activities from inception to December 31, 2008 and has an accumulated deficit of \$9,311,316 as at December 31, 2008. The Company will be pursuing further financings. Management believes it will be successful in raising the necessary funding to continue operations in the normal course of business, however, there is no assurance that these funds will be available on terms acceptable to the Company or at all. The Company's continued existence is dependent upon its ability to obtain additional financing as needed and to attain profitable operations.

If the going concern assumption were not appropriate for these financial statements, adjustments would be necessary to the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications used. Such adjustments could be material.

##### *Expenditures during the development stage*

The Company is in its development stage and has incurred capital and non-capital expenditures prior to the commencement of commercial operations. The Company has chosen to expense the non-capital expenditures as incurred.

##### *Cash and cash equivalents*

Cash and cash equivalents include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are not subject to significant risk of changes in value.

##### *Equipment*

Equipment is recorded at cost and is amortized on the diminishing balance method based on their estimated useful lives as follows:

|                        |   |                |
|------------------------|---|----------------|
| Computer equipment     | - | 30% per annum  |
| Furniture and fixtures | - | 20% per annum. |

##### *Long-term investment*

The Company accounted for its investment in Prairie Plant Systems Inc., a company in which it exercised significant influence, on the equity basis.

##### *Deferred compensation expense*

The cost of stock option compensation granted to consultants is deferred and amortized over the period that the services are provided.

Continued...

**Notes to the Financial Statements  
December 31, 2008 and 2007**

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**2. ACCOUNTING POLICIES AND GOING CONCERN (continued)***Other intangible assets*

Other intangible assets comprise a license for patented products that expires when the last patent expires. The asset is recorded at cost and will be amortized over the estimated useful life once commercial operations commence.

*Research and development costs*

Research costs are expensed as incurred. Development costs are expensed as incurred except if the product is defined and the costs attributable thereto can be identified, the future market for the product is defined and there exists adequate resources to complete the project. The Company has expensed all research and development costs incurred to date.

*Stock-option compensation*

The Company records compensation cost based on the fair value method of accounting for stock based compensation. The fair value of stock options is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. When options are exercised, the proceeds received, together with any related amount in contributed surplus, will be credited to share capital.

*Income taxes*

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the substantively enacted income tax rates for the years in which the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of enactment or substantive enactment of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and no net asset is recognized.

*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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates made by the Company include factors affecting valuations of stock-option compensation, warrants, other intangible assets and the valuation of income tax accounts. The Company regularly reviews its estimates and assumptions, however, actual results could differ from these estimates and these differences could be material. The Company's equity investment in Prairie Plant Systems Inc. ("PPS") included estimates and assumptions with respect to the carrying amount of the investment; the allocation of fair values to the underlying net assets acquired; and the amortization period of the values recorded.

*Loss per share*

Basic loss per share is calculated using the weighted number of shares outstanding. Diluted loss per share is calculated using the treasury stock method. In order to determine diluted loss per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted loss per share calculation. The diluted loss per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share. Total shares issuable from options, and warrants excluded from the computation of diluted loss per share because they were anti-dilutive for the year ended December 31, 2008 were 6,975,594 (2007 – 5,896,214) and 6,758,333 (2007 – 6,689,402), respectively.

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**Notes to the Financial Statements  
December 31, 2008 and 2007**

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**2. ACCOUNTING POLICIES AND GOING CONCERN (continued)***Financial instruments*

Financial assets and liabilities, including derivative instruments, are initially recognized and subsequently measured based on their classification as "held-for-trading", "available-for-sale" financial assets, "held-to-maturity", "loans and receivables" or "other" financial liabilities. Held-for-trading financial instruments are measured at their fair value with changes in fair value recognized in net loss for the period. Available-for-sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive loss until the asset is removed from the balance sheet. Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method. Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognized in net loss for the period, unless the instrument is a cash flow hedge and hedge accounting is applied, in which case changes in fair value are recognized in other comprehensive loss.

*Comprehensive loss*

Comprehensive loss, composed of net loss and other comprehensive loss, is defined as the change in shareholders' equity from transactions and other events from non-owner sources. Other comprehensive loss ("OCL") includes unrealized gains and losses on available-for-sale securities and changes in the fair market value of derivatives designated as cash flow hedges, all net of related income taxes. The components of comprehensive loss are disclosed in the statement of operations and comprehensive loss. Cumulative changes in other comprehensive loss are included in accumulated other comprehensive loss ("AOCL") which is presented as a category in shareholders' equity. The Company does not currently have any OCL items or AOCL. Therefore, comprehensive loss is equal to net loss for the years ended December 31, 2008 and 2007.

*Impairment of long-lived assets*

Long-lived assets held for use are reviewed for impairment when events or circumstances indicate that its carrying value may not be recoverable. When the carrying value is not expected to be recoverable from future cash flows on an undiscounted basis and the carrying value exceeds the asset's fair value, an impairment loss is recorded.

**3. CHANGES IN ACCOUNTING POLICIES***(a) Accounting Changes*

Effective January 1, 2008, the Company adopted the following accounting standards recently issued by the CICA:

*(i) Capital Disclosures*

In December 2006, the CICA issued Section 1535, "Capital Disclosures", which establishes guidelines for the disclosure of information on an entity's capital and how it is managed. This enhanced disclosure enables users to evaluate the entity's objectives, policies and processes for managing capital. The Company has included disclosures recommended by this new section in Note 3(c) to these financial statements.

*(ii) Financial Instruments – Disclosure and Presentation*

In December 2006, the CICA issued Section 3862, "Financial Instruments – Disclosure", and Section 3863, "Financial Instruments – Presentation" to replace the existing Section 3861 "Financial Instruments – Disclosure and Presentation". Section 3862 requires enhanced disclosure on the nature and extent of financial instrument risks and how an entity manages those risks. Section 3863 carries forward the existing presentation requirements and provides additional guidance for the classification of financial instruments. The Company has included disclosures recommended by this new section in Note 3(d) to these financial statements.

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

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**3. CHANGES IN ACCOUNTING POLICIES (continued)**

*(b) Recent Accounting Pronouncements*

*(i) Goodwill and Intangible Assets*

On February 1, 2008, the CICA issued section 3064, "Goodwill and Intangible Assets". This Section establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The changes are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The changes are effective for the Company beginning January 1, 2009. The adoption of this new Section is not expected to impact the financial statements of the Company.

*(ii) International Financial Reporting Standards ("IFRS")*

In January 2006, the Canadian Accounting Standards Board ("AcSB") announced its decision to replace Canadian GAAP with IFRS. On February 13, 2008 the AcSB confirmed January 1, 2011 as the mandatory changeover date to IFRS for all Canadian publicly accountable enterprises. This means that the Company will be required to prepare IFRS financial statements for the interim periods and fiscal year ends beginning in 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS on its results of operations, financial position and disclosures.

*(c) Capital Management*

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support its research and development activities. The Company's capital consists of share capital and contributed surplus. The Board of Directors does not establish quantitative return on capital criteria for management but rather relies on the expertise of the Company's management to sustain future development of the business.

The products which the Company currently has in its pipeline are in the research and development stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned research and development and pay for administration costs, the Company will spend its existing working capital and raise additional amounts as needed.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the year ended December 31, 2008.

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

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**3. CHANGES IN ACCOUNTING POLICIES (continued)**

*(d) Financial Risk Factors*

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

*(i) Credit Risk*

The Company has no significant concentration of credit risk arising from operations. Financial instruments included in sundry receivables consist primarily of goods and services tax due from the Federal Government of Canada. Management believes that the credit risk concentration with respect to these financial instruments is remote.

*(ii) Liquidity Risk*

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2008, the Company had cash and cash equivalents of \$805,128 and sundry receivables of \$53,636 (2007 - \$787,469 and \$70,893) to settle current liabilities of \$613,254 (2007 - \$470,446). All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms.

*(iii) Market Risk*

*(a) Interest rate risk*

The Company has cash and cash equivalent balances and \$100,000 in interest-bearing debt at a rate of 8% per annum (see Note 8) as at December 31, 2008. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by its banking institutions bearing interest at 3% per annum. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. The Company considers interest rate risk to be minimal as investments are short term, the Company has a relatively small amount of interest-bearing debt and future financing will be primarily secured from private placements.

*(b) Foreign currency risk*

The Company's functional currency is the Canadian dollar and most purchases are transacted in Canadian dollars. The Company funds certain research and development expenses in the United States and Europe on a cash call basis using the US Dollar and the EURO currency converted from its Canadian dollar bank accounts held in Canada. Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk. The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.

*(c) Price risk*

The Company is exposed to price risk with respect to Active Pharmaceutical Ingredient (API) prices used in research and development activities. The Company monitors API prices in the United States, Europe and Asia to determine the appropriate course of action to be taken by the Company.

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**3. CHANGES IN ACCOUNTING POLICIES (continued)**

*(d) Financial Risk Factors (continued)*

*(iv) Fair value*

The Company has designated its cash and cash equivalents as held-for-trading, measured at fair value. Sundry receivables are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and notes payable are classified as other financial liabilities, which are measured at amortized cost.

The carrying amounts for cash and cash equivalents, sundry receivables and accounts payable and accrued liabilities on the balance sheets approximate fair value because of the limited term of these instruments.

The carrying values of the notes payable approximate their fair values as current interest rates have not changed significantly.

**4. EQUIPMENT**

|                        | December 31, 2008 |                             |                   |
|------------------------|-------------------|-----------------------------|-------------------|
|                        | Cost              | Accumulated<br>Amortization | Net Book<br>Value |
|                        | \$                | \$                          | \$                |
| Computer equipment     | 5,745             | 4,286                       | 1,459             |
| Furniture and fixtures | 9,318             | 3,577                       | 5,741             |
| <b>Total</b>           | <b>15,063</b>     | <b>7,863</b>                | <b>7,200</b>      |

|                        | December 31, 2007 |                             |                   |
|------------------------|-------------------|-----------------------------|-------------------|
|                        | Cost              | Accumulated<br>Amortization | Net Book<br>Value |
|                        | \$                | \$                          | \$                |
| Computer equipment     | 5,746             | 3,661                       | 2,085             |
| Furniture and fixtures | 7,650             | 2,142                       | 5,508             |
| <b>Total</b>           | <b>13,396</b>     | <b>5,803</b>                | <b>7,593</b>      |

Continued...

## Notes to the Financial Statements

### December 31, 2008 and 2007

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#### 5. LONG-TERM INVESTMENT

|                                                                                                                                                            | December 31,<br>2008 | December 31,<br>2007 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Nil (2007 – 268,585) Class A common shares representing 0% (2007 – 12.06%) of the voting shares of Prairie Plant Systems Inc., recorded on an equity basis | \$ -                 | \$ 887,690           |

On June 23, 2008, the Company sold its investment in Prairie Plant Systems Inc. (“PPS”) for \$1,120,000, resulting in a gain on sale of \$254,936. In addition, the strategic alliance agreement between the Company and PPS was terminated. The Company’s share of the PPS loss from January 1, 2008 to June 23, 2008 was \$22,626 (for the year ended December 31, 2007 - \$96,662). The historical perspective of the PPS investment is included below.

In August 2004, the Company acquired 268,585 Class A common shares and 140,000 Class A common share purchase warrants of Prairie Plant Systems Inc. at a purchase price of \$1,120,001. The warrants were for additional Class A common shares and were exercisable at \$2.00 per share expiring May 14, 2006. The Company did not exercise these warrants.

In August 2004, the Company also extended a loan to PPS that was secured by a general security agreement. The loan had no fixed principal repayment terms and had a conversion option into Class A common shares at \$4.17 per share up to July 31, 2007. Interest was payable monthly on the principal balance at an annual rate of 7%. On July 17, 2007, the Company received \$480,000 from PPS, representing repayment of the loan outstanding. The Company also received \$46,277 to satisfy all interest owing.

On August 17, 2004, the Company entered into a strategic alliance agreement with PPS. In order to maintain this strategic alliance agreement, commencing in the fiscal year of PPS ending October 31, 2005, the Company made an on-going commitment to spend or contribute at least \$250,000 per fiscal year on one or more of the following cannabis or cannabinoid related activities: product development, clinical trials, pursuit of other strategic relationships, public relations, regulatory affairs, communications, marketing, and/or other such activities as the parties may reasonably agree upon. The Company expended the required \$250,000 commitment for the fiscal years of PPS ended October 31, 2007, 2006 and 2005, which was included in research and development expenses. The strategic alliance in the original agreement was to expire on October 31, 2016.

On August 17, 2004, the difference between the cost of the long-term investment in PPS and the underlying net book value of the assets acquired in PPS was calculated to be approximately \$952,000. Of this difference \$36,000 was related to PPS property, \$566,000 was related to current and expected contracts in favour of PPS and \$350,000 was related to goodwill. The underlying depreciable contracts valued at \$566,000 were amortized at an annual rate of approximately \$81,000 and were included in the calculation of the loss from equity accounted investment.

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL**

*a) Authorized*

Unlimited number of common shares with no par value

*b) Issued*

A summary of common shares, stock options and common share purchase warrants issued is as follows:

|                                | as at December 31, 2007  |                           |                            |                       |
|--------------------------------|--------------------------|---------------------------|----------------------------|-----------------------|
|                                | Number of<br>Shares<br># | Number of<br>Options<br># | Number of<br>Warrants<br># | Net<br>Proceeds<br>\$ |
| Common                         | 70,010,516               | -                         | -                          | 7,541,430             |
| Stock options                  | -                        | 3,243,740                 | -                          | -                     |
| Common share purchase warrants | -                        | -                         | 4,939,402                  | 264,143               |
| <b>Total</b>                   | <b>70,010,516</b>        | <b>3,243,740</b>          | <b>4,939,402</b>           | <b>7,805,573</b>      |

|                                | as at December 31, 2008  |                           |                            |                       |
|--------------------------------|--------------------------|---------------------------|----------------------------|-----------------------|
|                                | Number of<br>Shares<br># | Number of<br>Options<br># | Number of<br>Warrants<br># | Net<br>Proceeds<br>\$ |
| Common                         | 74,643,849               | -                         | -                          | 8,089,432             |
| Stock options                  | -                        | 4,594,016                 | -                          | -                     |
| Common share purchase warrants | -                        | -                         | 5,008,333                  | 152,468               |
| <b>Total</b>                   | <b>74,643,849</b>        | <b>4,594,016</b>          | <b>5,008,333</b>           | <b>8,241,900</b>      |

A summary of common shares and number of shares issuable on exercise of stock options and warrants is as follows:

|                                | as at December 31, 2008                                        |                                                                 |                  |                   |
|--------------------------------|----------------------------------------------------------------|-----------------------------------------------------------------|------------------|-------------------|
| Number of<br>Shares<br>#       | Number of<br>Shares Issuable<br>on Exercise of<br>Options<br># | Number of<br>Shares Issuable<br>on exercise of<br>Warrants<br># | Total<br>#       |                   |
| Common                         | 74,643,849                                                     | -                                                               | -                | 74,643,849        |
| Stock options                  | -                                                              | 6,975,594                                                       | -                | 6,975,594         |
| Common share purchase warrants | -                                                              | -                                                               | 6,758,333        | 6,758,333         |
| <b>Total</b>                   | <b>74,643,849</b>                                              | <b>6,975,594</b>                                                | <b>6,758,333</b> | <b>88,377,776</b> |

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL (continued)**

*b) Issued (continued)*

At December 31, 2008, the following common shares, and common share purchase warrants were issued for the proceeds noted.

|                                                                          | Number of<br>Shares<br>#   | Proceeds<br>\$ | Share Issuance<br>Costs<br>\$ | Net<br>Proceeds<br>\$ |
|--------------------------------------------------------------------------|----------------------------|----------------|-------------------------------|-----------------------|
| <b>Total Shares and Proceeds, December 31, 2006</b>                      | 66,014,957                 | 7,700,767      | 797,530                       | 6,903,237             |
| March 13, 2007 (i)                                                       | 123,675                    | 35,000         | -                             | 35,000                |
| March 23, 2007 (ii)                                                      | 81,658                     | 19,500         | -                             | 19,500                |
| April 25, 2007 (iii)                                                     | 3,790,226                  | 654,315        | 70,622                        | 583,693               |
| <b>Total Shares and Proceeds, December 31, 2007</b>                      | 70,010,516                 | 8,409,582      | 868,152                       | 7,541,430             |
| March 14, 2008 (vi)                                                      | 3,333,333                  | 396,270        | 36,400                        | 359,870               |
| June 27, 2008 (viii)                                                     | 125,000                    | 25,000         | -                             | 25,000                |
| August 8, 2008 (x)                                                       | 1,175,000                  | 173,158        | 10,026                        | 163,132               |
| <b>Total Shares and Proceeds, December 31, 2008</b>                      | 74,643,849                 | 9,004,010      | 914,578                       | 8,089,432             |
|                                                                          |                            |                |                               |                       |
|                                                                          | Number of<br>Warrants<br># | Proceeds<br>\$ | Share Issuance<br>Costs<br>\$ | Net<br>Proceeds<br>\$ |
| <b>Total Share Purchase Warrants and Proceeds,<br/>December 31, 2006</b> | 4,535,586                  | 354,450        | 25,239                        | 329,211               |
| April 25, 2007 (iii)                                                     | 1,895,112                  | 179,535        | 19,342                        | 160,193               |
| April 25, 2007 (iii)                                                     | 275,704                    | -              | -                             | -                     |
| June 29, 2007 (iv)                                                       | (239,500)                  | -              | -                             | -                     |
| September, 15 2007 (v)                                                   | (1,527,500)                | (240,000)      | (14,739)                      | (225,261)             |
| <b>Total Share Purchase Warrants and Proceeds,<br/>December 31, 2007</b> | 4,939,402                  | 293,985        | 29,842                        | 264,143               |
| March 14, 2008 (vi)                                                      | 3,333,333                  | 103,730        | 9,523                         | 94,207                |
| March 15, 2008 (vii)                                                     | (361,086)                  | -              | -                             | -                     |
| August 3, 2008 (ix)                                                      | (1,907,500)                | (114,450)      | (10,500)                      | (103,950)             |
| August 8, 2008 (x)                                                       | 1,175,000                  | 61,842         | 3,581                         | 58,261                |
| October 24, 2008 (xi)                                                    | (1,895,112)                | (179,535)      | (19,342)                      | (160,193)             |
| October 24, 2008 (xii)                                                   | (275,704)                  | -              | -                             | -                     |
| <b>Total Share Purchase Warrants and Proceeds,<br/>December 31, 2008</b> | 5,008,333                  | 165,572        | 13,104                        | 152,468               |
| <b>TOTAL PROCEEDS FROM SHARES AND WARRANTS,<br/>DECEMBER 31, 2008</b>    |                            | 9,169,582      | 927,682                       | 8,241,900             |

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

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**6. SHARE CAPITAL (continued)**

*b) Issued (continued)*

- i) On March 13, 2007, 123,675 common shares, valued at \$35,000, were issued for consulting services provided in 2006. The Board of Directors of the Company approved this transaction on November 23, 2006.
- ii) On March 23, 2007, 97,500 options with an expiry date of March 23, 2007, were exercised to acquire 81,658 common shares for total proceeds of \$19,500.
- iii) On April 25, 2007, the Company issued an aggregate of 3,790,226 Units at a price of \$0.22 per Unit raising gross proceeds of \$833,850. Each Unit consists of one common share and a half share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one common share at a price of \$0.30 for a period ending on the earlier of October 24, 2008 and a period ending 20 days after prior written notice from Cannasat that the closing price of its shares on the principal stock exchange of Cannasat has been at least \$0.50 per share for 20 consecutive trading days. The grant date fair value of these warrants was estimated at \$179,535.

As part of the private placement, 275,704 broker's warrants were also issued. Each broker warrant entitles the holder to acquire one share at an exercise price of \$0.22 per share and shall otherwise be exercisable on the same terms as the share purchase warrants. The broker's warrants were issued as compensation for services performed and their estimated fair value of \$30,904 is recorded in Contributed Surplus.

The fair values of the above warrants were estimated using the Black-Scholes option pricing model based on the following assumptions: risk-free interest rate of 4.7%, expected life of 1.5 years, expected dividend rate of 0%, and expected volatility of 126%.

- iv) On June 29, 2007, 239,500 warrants expired. These warrants had been issued in lieu of compensation and their estimated grant date fair value was recorded directly to Contributed Surplus.
- v) On September 15, 2007, 1,527,500 warrants expired.
- vi) On March 14, 2008, the Company issued 3,333,333 units at \$0.15 per unit for gross proceeds of \$500,000. Each unit consists of one common share and one common share purchase warrant. Each warrant entitles the holder to acquire one common share of the Company for \$0.20 per share until the earlier of March 14, 2009 and the period ending 20 days after prior written notice from the Company that the closing price of its shares on the Toronto Stock Exchange has been at least \$0.30 per share for 20 consecutive trading days. The grant date fair value of the warrants was estimated at \$103,730 using the Black-Scholes option pricing model based on the following assumptions: risk-free interest rate of 2.5%, expected life of 1 year, expected dividend rate of 0%, and expected volatility of 97%.
- vii) On March 15, 2008, 361,086 warrants expired. These warrants had been issued on March 22, 2006 in lieu of compensation and their estimated grant date fair value was recorded directly to contributed surplus on that date.
- viii) On June 27, 2008, 125,000 common shares, valued at \$25,000, were issued for consulting services provided during the second quarter of 2008. The Board of Directors of the Company approved this share issuance on June 25, 2008.

Continued...



**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL (continued)**

*b) Issued (continued)*

- ix) On August 3, 2008, 1,907,500 warrants expired. These warrants had been issued on August 3, 2006, as part of a private placement consisting of one common share and one half of one common share purchase warrant at a subscription price of \$0.20 per unit.
- x) On August 8, 2008 the Company issued an aggregate of 1,175,000 Units at a price of \$0.20 per Unit raising gross proceeds of \$235,000. Each Unit consists of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to acquire one common share at a price of \$0.22 for a period ending on the earlier of 18 months from the closing date, and a period ending 20 days after prior written notice from the Company that the closing price of its shares on the principal stock exchange of the Company has been at least \$0.30 per share for 20 consecutive trading days. The fair value of the warrants was estimated at \$61,842 using the Black-Scholes option pricing model based on the following assumptions: risk-free interest rate of 2.8%, expected life of 1.5 years, expected dividend rate of 0%, and expected volatility of 96%.
- xi) On October 24, 2008, 1,895,112 warrants expired. These warrants had been issued on April 25, 2007, as part of a private placement consisting of one common share and one half of one common share purchase warrant at a subscription price of \$0.30 per unit.
- xii) On October 24, 2008, 275,704 warrants expired. These warrants had been issued on April 25, 2007 in lieu of compensation and their estimated grant date fair value was recorded directly to Contributed Surplus on that date.

*c) Stock options and warrants*

A summary of the status of options:

|                                            | Number<br>of<br>Options | Number of<br>Shares Issuable<br>on Exercise of<br>Options | Weighted<br>Exercise<br>Price<br>(/share) |
|--------------------------------------------|-------------------------|-----------------------------------------------------------|-------------------------------------------|
|                                            | #                       | #                                                         | \$                                        |
| Options outstanding at December 31, 2006   | 3,021,240               | 5,594,505                                                 | 0.286                                     |
| Exercised                                  | (97,500)                | (81,658)                                                  | 0.239                                     |
| Granted                                    | 1,710,000               | 1,710,000                                                 | 0.250                                     |
| Expired                                    | (1,390,000)             | (1,326,633)                                               | 0.266                                     |
| Options outstanding at December 31, 2007   | 3,243,740               | 5,896,214                                                 | 0.280                                     |
| Granted                                    | 1,850,000               | 1,850,000                                                 | 0.200                                     |
| Expired                                    | (499,724)               | (770,620)                                                 | 0.293                                     |
| <u>Outstanding as at December 31, 2008</u> | <u>4,594,016</u>        | <u>6,975,594</u>                                          | <u>0.257</u>                              |

The weighted average grant date fair value of the stock options issued during the year ended December 31, 2008 is \$0.14 (2007: \$0.16). The fair value of the options granted during the year ended December 31, 2008, has been estimated on the date of issue using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0% (2007: 0%), expected volatilities between 94% and 98% (2007: 106% - 108%), risk free rate of return interest rates between 3.27% and 3.07% (2007: 4.41% - 4.63%) and expected lives of 2 and 5 years (2007: 5 years).

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL (continued)**

*c) Stock options and warrants (continued)*

In February 2004, 2,610,000 options granted were determined to have a value of \$513,485. Of this amount, \$109,485 was expensed in 2004, \$100,000 was expensed during the year ended December 31, 2005, and \$96,000 was expensed during each of the years ended December 31, 2006, December 31, 2007 and December 31, 2008. The remaining \$16,000 was deferred to future periods.

Stock options issued and outstanding as at December 31, 2008 are as follows:

| Number of Options | Number of Shares issuable on exercise of options | Effective Strike Price (\$/share) | Vesting Date      | Expiry Date       |
|-------------------|--------------------------------------------------|-----------------------------------|-------------------|-------------------|
| #                 | #                                                | \$                                |                   |                   |
| 64,646            | 54,145                                           | 0.239                             | July 28, 2005     | March 31, 2009    |
| 70,620            | 70,620                                           | 0.300                             | December 4, 2006  | March 31, 2009    |
| 25,000            | 75,000                                           | 0.317                             | December 31, 2005 | March 31, 2009    |
| 50,000            | 150,000                                          | 0.283                             | August 18, 2004   | August 18, 2009   |
| 150,000           | 450,000                                          | 0.283                             | December 31, 2004 | December 31, 2009 |
| 66,666            | 66,666                                           | 0.200                             | December 25, 2008 | June 25, 2010     |
| 66,667            | 66,667                                           | 0.200                             | June 25, 2009     | June 25, 2010     |
| 66,667            | 66,667                                           | 0.200                             | December 25, 2009 | June 25, 2010     |
| 41,667            | 125,000                                          | 0.283                             | June 30, 2006     | June 30, 2010     |
| 48,750            | 40,829                                           | 0.239                             | July 28, 2005     | July 28, 2010     |
| 66,667            | 200,000                                          | 0.317                             | August 31, 2006   | August 31, 2010   |
| 150,000           | 150,000                                          | 0.300                             | December 4, 2006  | December 3, 2010  |
| 41,666            | 125,000                                          | 0.283                             | December 31, 2006 | December 31, 2010 |
| 50,000            | 150,000                                          | 0.283                             | March 23, 2007    | March 23, 2011    |
| 58,333            | 175,000                                          | 0.283                             | June 30, 2007     | June 30, 2011     |
| 150,000           | 450,000                                          | 0.283                             | June 30, 2007     | June 30, 2011     |
| 66,667            | 200,000                                          | 0.317                             | August 31, 2007   | August 31, 2011   |
| 50,000            | 150,000                                          | 0.283                             | August 31, 2007   | August 31, 2011   |
| 250,000           | 750,000                                          | 0.283                             | November 1, 2007  | November 1, 2011  |
| 50,000            | 50,000                                           | 0.300                             | December 4, 2007  | December 3, 2011  |
| 16,667            | 50,000                                           | 0.283                             | December 31, 2007 | December 31, 2011 |
| 100,000           | 300,000                                          | 0.283                             | December 31, 2007 | December 31, 2011 |
| 86,667            | 86,667                                           | 0.250                             | November 24, 2007 | May 24, 2012      |
| 86,667            | 86,667                                           | 0.250                             | May 24, 2008      | May 24, 2012      |
| 86,667            | 86,667                                           | 0.250                             | November 24, 2008 | May 24, 2012      |
| 283,337           | 283,337                                          | 0.250                             | June 25, 2008     | June 25, 2012     |
| 283,331           | 283,331                                          | 0.250                             | June 25, 2009     | June 25, 2012     |
| 283,331           | 283,331                                          | 0.250                             | June 25, 2010     | June 25, 2012     |
| 16,667            | 50,000                                           | 0.283                             | June 30, 2008     | June 30, 2012     |

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL (continued)**

*c) Stock options and warrants (continued)*

| Number of Options | Number of Shares Issuable on Exercise of Options | Effective Strike Price (\$/share) | Vesting Date      | Expiry Date      |
|-------------------|--------------------------------------------------|-----------------------------------|-------------------|------------------|
| #                 | #                                                | \$                                |                   |                  |
| 66,667            | 200,000                                          | 0.317                             | August 31, 2008   | August 31, 2012  |
| 50,000            | 50,000                                           | 0.300                             | December 4, 2008  | December 3, 2012 |
| 200,000           | 200,000                                          | 0.200                             | April 4, 2009     | April 4, 2013    |
| 200,000           | 200,000                                          | 0.200                             | April 4, 2010     | April 4, 2013    |
| 200,000           | 200,000                                          | 0.200                             | April 4, 2011     | April 4, 2013    |
| 266,666           | 266,666                                          | 0.200                             | June 25, 2009     | June 25, 2013    |
| 266,667           | 266,667                                          | 0.200                             | June 25, 2010     | June 25, 2013    |
| 266,667           | 266,667                                          | 0.200                             | June 25, 2011     | June 25, 2013    |
| 83,334            | 83,334                                           | 0.200                             | February 28, 2009 | August 28, 2013  |
| 83,333            | 83,333                                           | 0.200                             | August 28, 2009   | August 28, 2013  |
| 83,333            | 83,333                                           | 0.200                             | February 28, 2010 | August 28, 2013  |
| 4,594,016         | 6,975,594                                        |                                   |                   |                  |

The total number of common shares that are issuable pursuant to stock options that are exercisable as at December 31, 2008 is 4,500,833.

Details of the warrants outstanding as at December 31, 2008 are as follows:

|                                     | Number of Warrants | Number of shares Issuable on Exercise of Warrants | Weighted Exercise Price (/share) |
|-------------------------------------|--------------------|---------------------------------------------------|----------------------------------|
|                                     | #                  | #                                                 | \$                               |
| Outstanding as at December 31, 2006 | 4,535,586          | 11,592,921                                        | 0.264                            |
| Granted                             | 2,170,816          | 2,170,816                                         | 0.287                            |
| Expired                             | (1,767,000)        | (7,074,335)                                       | 0.277                            |
| Outstanding as at December 31, 2007 | 4,939,402          | 6,689,402                                         | 0.259                            |
| Granted                             | 4,508,333          | 4,508,333                                         | 0.205                            |
| Expired                             | (4,439,402)        | (4,439,402)                                       | 0.300                            |
| Outstanding as at December 31, 2008 | 5,008,333          | 6,758,333                                         | 0.211                            |

The weighted average grant date fair value of the warrants issued during the year ended December 31, 2008 is \$0.03 (2007 - \$0.11). The fair value of the warrants granted during the period ended December 31, 2008 has been estimated on the date of issue using the Black-Scholes pricing model with the following assumptions: expected dividend yield 0%, expected volatility between 97% and 99%, risk-free interest rate between 2.63% and 2.93% and an expected life of between one and one and one half years.

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

**6. SHARE CAPITAL (continued)**

*c) Stock options and warrants (continued)*

Warrants outstanding and exercisable as at December 31, 2008 are as follows:

| Number of Warrants | Number of shares issuable on exercise of warrants<br># | Effective Strike Price (/share)<br>\$ | Fair value<br>\$ | Expiry Date      |
|--------------------|--------------------------------------------------------|---------------------------------------|------------------|------------------|
| 3,333,333          | 3,333,333                                              | 0.200                                 | 94,207           | March 14, 2009   |
| 500,000            | 2,250,000                                              | 0.222                                 | 120,000          | March 16, 2009*  |
| 1,175,000          | 1,175,000                                              | 0.220                                 | 58,261           | February 8, 2010 |
| 5,008,333          | 6,758,333                                              |                                       | 272,468          |                  |

\* These warrants were issued as compensation for services performed and their fair value is recorded in contributed surplus. The remaining warrants were issued pursuant to private placements and their fair value is recorded as part of share capital.

*d) Escrowed shares*

On March 15, 2006, Cannasat amalgamated with Lonsdale Public Ventures (“Lonsdale”), a capital pool company. Immediately following the amalgamation, 38,705,837 common shares of the Company were subject to escrow. 34,608,879 of these escrowed shares are to be released over a period of 72 months on the basis of 5% to be released six months after the final Exchange bulletin (March 23, 2006), 5% to be released every six months thereafter for the next 18 months and 10% to be released every six months thereafter for the next 48 months. The remaining 4,096,958 escrowed shares are to be released over a period of 36 months on the basis of 10% to be released on the date of the final Exchange bulletin and 15% to be released every six months thereafter.

At December 31, 2008, 24,226,220 of the 72-month release shares and 614,547 of the 36-month release shares are still subject to escrow (Note 13).

*e) Contributed Surplus*

Contributed surplus represents the fair value of unexercised and expired warrants as well as the unexercised fair value of stock option compensation earned by directors, officers, employees and certain consultants of the Company as follows:

|                                                         |              |
|---------------------------------------------------------|--------------|
| Balance, December 31, 2006, as originally reported      | \$ 574,222   |
| Correction of error (i)                                 | 108,555      |
| Compensation earned during the period – employee        | 90,582       |
| Compensation earned during the period – non-employee    | 110,307      |
| Expiry of warrants, September 15, 2007                  | 225,261      |
| Balance, December 31, 2007                              | \$ 1,108,927 |
| Compensation earned during the period – employee        | 116,650      |
| Compensation earned during the period – non-employee    | 48,406       |
| Expiry of warrants, August 3, 2008 and October 24, 2008 | 264,143      |
| Balance December 31, 2008                               | \$ 1,538,126 |

Continued...

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

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**6. SHARE CAPITAL (continued)**

*e) Contributed Surplus (continued)*

- (i) The Company has restated certain components of shareholders' equity for the year ended December 31, 2007 in respect of an error in the calculation of stock-based compensation relating to prior years. As a result of this error, contributed surplus and deficit were understated by \$108,555. Deficit as at December 31, 2006 has been increased by \$108,555 from \$4,977,970 to \$5,086,525. The error had no effect on net loss, net loss per share or total shareholders equity.

**7. OTHER INTANGIBLE ASSETS**

On June 10, 2005, the Company entered into a license agreement with a research and development company. The License fee of \$200,000 was satisfied by the execution and delivery of two promissory notes on June 30, 2005 (see Note 8) in the aggregate principal amount of \$100,000 and the issuance of 117,648 Class A common shares at an aggregate subscription price of \$100,000. In addition to the acquisition costs, the Company has agreed to pay a combination of milestone-based payments and royalties. The license is for patents that have been issued in certain jurisdictions and are currently pending in others.

**8. NOTES PAYABLE**

Promissory notes in the aggregate principal amount of \$100,000 were issued by the Company on June 30, 2005 in connection with the signing of the agreement for the worldwide license to make, use or sell certain licensed products (see Note 7). The notes bear interest at 8% per annum, calculated monthly and payable in quarterly installments effective January 1, 2006. The first note in the principal amount of \$50,000 was due on demand no earlier than December 30, 2005 and may be converted in whole or in part into common shares no later than June 30, 2009 at \$0.2833 per share at the option of the holder. The second promissory note also with a principal amount of \$50,000 is due on demand no earlier than the date of issuance of filed patents in specific jurisdictions. In the event that the filed patents are not issued, 88,236 Class A common shares at \$0.2833 per share may be issued at the option of the issuer as full and final settlement of the note. The second promissory note may be converted in whole or in part into common shares no later than June 30, 2009 at \$0.2833 per share at the option of the holder. Included in general and administrative expenses is \$4,812 (2007 - \$9,693) in interest expense relating to these promissory notes.

**9. RELATED PARTY TRANSACTIONS**

Related party transactions during the years ended December 31, 2008 and 2007 are as follows:

|                                        | 2008              | 2007             |
|----------------------------------------|-------------------|------------------|
| Management fees                        | \$ 174,000        | \$150,000        |
| Director fees                          | 27,650            | 10,950           |
| Consulting services paid to a Director | -                 | 17,276           |
|                                        | <u>\$ 201,650</u> | <u>\$178,226</u> |

At December 31, 2008, included in accounts payable and accrued liabilities is \$1,513 (2007 - \$21,797) due to officers and directors of the Company. At December 31, 2008, included in sundry receivables is \$2,265 (2007 - \$9,393) due from officers of the Company. These amounts are unsecured, non-interest bearing with no fixed terms of repayment. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
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**10. INCOME TAXES**

- a) Provision for income taxes:

Major items causing the Company's income tax rate to differ from the Canadian combined federal and provincial statutory rate of approximately 33.5% (2007 – 36.1%) are as follows:

|                                             | December 31,<br><u>2008</u> | December 31,<br><u>2007</u> |
|---------------------------------------------|-----------------------------|-----------------------------|
| Loss before income taxes                    | \$ (1,992,015)              | \$(2,232,776)               |
| Expected income tax recovery                | \$ (667,000)                | \$ (804,000)                |
| Adjustments to benefit resulting from:      |                             |                             |
| Difference in income tax rates              | 90,000                      | 156,000                     |
| Change in income tax rates                  | -                           | 336,000                     |
| Share issue costs                           | (17,000)                    | (17,000)                    |
| Stock option compensation                   | 76,000                      | 77,000                      |
| (Gain) loss from Prairie Plant Systems Inc. | (34,000)                    | 14,000                      |
| Other                                       | (8,000)                     | 80,000                      |
|                                             | \$ (560,000)                | \$ (158,000)                |
| Change in valuation allowance               | 560,000                     | 158,000                     |
|                                             | \$ -                        | \$ -                        |

- b) The effect of temporary differences that give rise to future income taxes assets and liabilities are as follows:

|                                          | December 31,<br><u>2008</u> | December 31,<br><u>2007</u> |
|------------------------------------------|-----------------------------|-----------------------------|
| Future income tax assets:                |                             |                             |
| Share issuance costs                     | \$ 76,000                   | \$106,000                   |
| Investment in Prairie Plant Systems Inc. | -                           | 34,000                      |
| Equipment                                | 2,000                       | 1,000                       |
| Tax loss carry forwards                  | 2,364,000                   | 1,741,000                   |
|                                          | \$ 2,442,000                | \$ 1,882,000                |
| Future income tax liabilities            | -                           | -                           |
| Valuation allowance                      | (2,442,000)                 | (1,882,000)                 |
|                                          | \$ -                        | \$ -                        |

- c) The Company has approximately \$8,153,000 of non-capital losses as at December 31, 2008, which under certain circumstances can be used to reduce the taxable income of future years. The non-capital losses expire as follows:

| <u>Available To</u> | <u>Amount (\$)</u> |
|---------------------|--------------------|
| 2014                | 501,000            |
| 2015                | 1,340,000          |
| 2026                | 2,156,000          |
| 2027                | 2,048,000          |
| 2028                | <u>2,108,000</u>   |
|                     | <u>8,153,000</u>   |

**CANNASAT THERAPEUTICS INC.**  
**Notes to the Financial Statements**  
**December 31, 2008 and 2007**

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**11. COMMITMENTS AND CONTINGENCIES**

The Company is party to certain management contracts for its executive officers. Minimum management contract termination commitments remaining under the agreements are approximately \$240,000 and are all payable within one year.

The Company has entered into a lease for its office premises in Toronto. Minimum rental commitments approximate \$37,000 all due within one year.

The Company has been named as a defendant in a legal action claiming \$87,500 in damages. Included in accounts payable and accrued liabilities is \$30,000 related to this action. The Company also has two contractual disputes totalling \$64,500. Included in accounts payable and accrued liabilities is \$10,000 related to these disputes. Management believes that the claims are without merit and plans to vigorously defend the Company.

The Company has entered into research and development contracts requiring total payments of approximately \$192,000 which are due upon the completion of certain performance criteria.

**12. SUPPLEMENTARY CASH FLOW INFORMATION**

|                   | 2008  | 2007  |
|-------------------|-------|-------|
| Income taxes paid | \$ -  | \$ -  |
| Interest paid     | 4,812 | 9,693 |

The following significant transactions did not generate or use cash:

|                                                     |           |           |
|-----------------------------------------------------|-----------|-----------|
| Broker warrants issued for issue costs              | -         | 30,904    |
| Common shares issued for services (Note 6(b)(viii)) | (25,000)  | -         |
| Common shares to be issued                          | -         | 35,000    |
| Contributed surplus                                 | 264,143   | 426,150   |
| Compensation expense                                | (261,056) | (265,985) |

**13. SUBSEQUENT EVENTS**

- (a) On February 27, 2009, the Company, as part of a private placement, issued 3,870,000 units at a price of \$0.10 per unit for gross proceeds of \$387,000. Each unit consists of one common share and one half of a common share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price of \$0.15 per share until February 26, 2011. Certain officers and directors of the Company purchased 770,000 units as part of this private placement for gross proceeds of \$77,000.
- (b) On March 14, 2009, 3,333,333 warrants exercisable at \$0.20 per share expired unexercised.
- (c) On March 16, 2009, 500,000 warrants exercisable at \$0.22 per share expired unexercised.
- (d) On March 23, 2009, a total of 4,075,431 shares were released from escrow, leaving a balance of 20,765,336 still in escrow.
- (e) On March 31, 2009, 160,266 stock options exercisable into 199,765 common shares at exercise prices of \$0.239, \$0.30 and \$0.317 per share expired unexercised.