

Financial Statements

Stem Cell Therapeutics Corp.

[Formerly Neurogenesis Biotech Corp.]

[a development stage company]

December 31, 2004

AUDITORS' REPORT

To the Shareholders of
Stem Cell Therapeutics Corp.

We have audited the balance sheet of **Stem Cell Therapeutics Corp.** [formerly Neurogenesis Biotech Corp.] as at December 31, 2004 and the statements of operations and deficit and cash flows for the period from inception on April 1, 2004 to December 31, 2004. 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 audit.

We conducted our audit 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, 2004 and the results of its operations and its cash flows for the period from inception on April 1, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
February 16, 2005

Ernst + Young LLP

Chartered Accountants

Stem Cell Therapeutics Corp.
[formerly Neurogenesis Biotech Corp.]
[a development stage company]

BALANCE SHEET

As at December 31, 2004

	2004
	\$
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ASSETS	
Current	
Cash	422,899
Short-term investment	40,000
Prepaid expenses	92,955
	<hr/> 555,854
Property and equipment, net <i>[note 3]</i>	45,150
Intellectual property, net <i>[note 4]</i>	2,371,641
	<hr/> 2,972,645
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LIABILITIES AND SHAREHOLDERS' EQUITY	
Current	
Accounts payable and accrued liabilities <i>[note 5]</i>	185,851
Current portion of obligation under share purchase agreement <i>[note 6]</i>	162,058
Current portion of capital lease obligation <i>[note 8]</i>	2,803
	<hr/> 350,712
Obligation under share purchase agreement <i>[note 6]</i>	1,924,221
Capital lease obligation <i>[note 8]</i>	2,343
	<hr/>
Commitments and contingencies <i>[note 9]</i>	
Shareholders' equity	
Share capital <i>[note 11]</i>	1,490,593
Contributed surplus <i>[note 11[d]]</i>	154,641
Deficit	(949,865)
Total shareholders' equity	<hr/> 695,369
	<hr/> 2,972,645

See accompanying notes

On behalf of the Board:

“Geoff Shmigelsky”
Director

“Joseph Tucker”
Director

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STATEMENT OF LOSS AND DEFICIT

Nine-month period ended December 31,

	2004
	\$
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OPERATING EXPENSES	
Research and development costs <i>[note 10]</i>	206,038
Professional fees	194,396
Management and consulting fees	117,823
General and administration <i>[note 5]</i>	121,560
Stock option expense <i>[note 11[d]]</i>	174,641
Deemed interest expense on obligation under share purchase agreement <i>[note 6]</i>	75,449
Amortization of property and equipment	4,158
Amortization of intellectual property	59,638
	<hr/> 953,703
Interest income	3,838
Net loss for the period <i>[note 7]</i>	949,865
Deficit beginning of period	—
Deficit, end of period	949,865
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Basic and diluted loss per share <i>[note 2]</i>	0.08

See accompanying notes

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STATEMENT OF CASH FLOWS

Nine-month period ended December 31,

	2004
	\$
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OPERATING ACTIVITIES	
Net loss for the period	(949,865)
Add items not involving cash	
Stock option expense	174,641
Amortization of property and equipment	4,158
Amortization of intellectual property	59,638
	<hr/>
	(711,428)
Changes in non-cash working capital items	
Prepaid expenses	(92,955)
Accounts payable and accrued liabilities	185,851
	<hr/>
Cash used in operating activities	(618,532)
<hr/>	
INVESTING ACTIVITIES	
Acquisition of property and equipment	(49,308)
Acquisition of intellectual property	(327,000)
Short-term investment	(40,000)
	<hr/>
Cash used in investing activities	(416,308)
<hr/>	
FINANCING ACTIVITIES	
Net increase in capital lease obligation	5,146
Issuance of share capital, net of share issue costs	1,452,593
	<hr/>
Net cash provided by financing activities	1,457,739
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Net increase in cash during the period	422,899
Cash, beginning of period	—
	<hr/>
Cash, end of period	422,899
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See accompanying notes

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NOTES TO FINANCIAL STATEMENTS

December 31, 2004

1. DESCRIPTION OF BUSINESS

Stem Cell Therapeutics Corp. (the "Company") was incorporated under the laws of Alberta on March 31, 2004 with nominal share capital. On October 19, 2004, the Company changed its name from Neurogenesis Biotech Corp. to Stem Cell Therapeutics Corp. The Company was created to further develop and commercialize stem cell related technologies acquired from an Alberta based university. To date, the Company has not earned product revenue and is considered to be in the development stage.

The continuation of the Company's research and development activity and the commercialization of its stem cell related technologies is dependent on the Company's ability to complete its research and development programs, achieve future profitable operations and finance its cash requirements. The outcome of these matters cannot be predicted at this time. The value of the Company's intangible assets could become impaired should their research and development activities change significantly or cease.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies are summarized as follows:

Use of estimates

The preparation of these 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 amounts of revenue and expenses during the reporting period. Actual results may vary from those estimates.

Short-term investment

Short-term investment, consisting of a guaranteed investment certificate, is a liquid investment that is readily convertible to known amounts of cash and is subject to an insignificant risk of changes in value with original maturities of less than two years at the time of purchase. The short-term investment held at December 31, 2004 bears interest at 1.5% per annum. The investment is carried at the lower of cost and market value.

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Property and equipment

Property and equipment are recorded at cost less accumulated amortization over each quarter. Amortization is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Computer equipment	3 years
Computer software	2 years
Office furniture and equipment	5 years

Intellectual property

Intellectual property represents the value of intellectual property as of the acquisition date which is amortized on a straight-line basis over its estimated useful life of 10 years.

Financial instruments

The Company's financial instruments consist of cash and cash equivalents, short-term investment, prepaid expenses, accounts payable, and capital lease obligations. The carrying value of these financial instruments approximates the fair value due to the short-term nature of the instruments.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the exchange rate prevailing at the balance sheet date. Foreign denominated transactions are translated at the exchange rates prevailing at the transaction dates.

Impairment or disposal of long-lived assets

The Company tests long-lived assets or asset groups for recoverability when events or changes in circumstances indicate that their carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of the assets and their net recoverable values, which are generally determined based on undiscounted cash flows expected to result from the use and the eventual disposal of the assets. If the carrying value of the assets is not recoverable, an impairment loss is recognized to write down the assets to their fair value.

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Income taxes

The Company follows the liability method of accounting for income taxes. Under the liability method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when 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 income or loss in the year that the income tax rates change occurs.

Investment tax credits

The Company recognizes investment tax credits for qualifying research and development costs on a cash basis. The Company accounts for investment tax credits relating to research and development expenses as a reduction of such expenses and those relating to capital expenditures as a reduction of the cost of the asset acquired. No investment tax credits have been recorded in these financial statements as there is no reasonable assurance of realization.

Loss per share

Basic and diluted net loss per share has been calculated using the weighted-average number of common shares outstanding during the period. Diluted loss per share is calculated in accordance with the treasury stock method. This method assumes that any proceeds from the exercise of stock options or the conversion of Class B shares would be used to purchase common shares at the average share price during the period. The Company has excluded all outstanding stock options and Class B shares from the calculation of diluted loss per share because all such securities are considered anti-dilutive.

Research and development

Research costs, other than capital expenditures that have alternative uses, are expensed as incurred. Development costs that meet specific criteria related to technical, market and financial feasibility are capitalized. All development costs incurred to date have been expensed.

Stock-based compensation

The Company uses the fair value-based method of accounting for all stock-based compensation granted to employees. The fair value of the stock options is determined using the Black-Scholes option-pricing model. The compensation expense is recognized in the statement of loss using a straight-line method over the vesting period of the stock options.

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NOTES TO FINANCIAL STATEMENTS

December 31, 2004

3. PROPERTY AND EQUIPMENT

	2004		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	27,052	1,978	25,074
Computer software	4,721	504	4,217
Office furniture and equipment	17,535	1,676	15,859
	49,308	4,158	45,150

Included in computer equipment are assets under capital lease at a cost of \$5,603, and accumulated amortization of \$679.

4. INTELLECTUAL PROPERTY

	2004		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Intellectual property			
Owned by the Company	20,000	1,503	18,497
Subject to purchase commitments <i>[note 6]</i>	2,411,279	58,135	2,353,144
	2,431,279	59,638	2,371,641

A portion of the intellectual property was acquired for \$20,000 which represents the fair value of the intellectual property acquired and was paid through the issuance of 3,636,364 Common shares with a value of \$18,000 and a \$2,000 cash payment.

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5. RELATED PARTY TRANSACTIONS

Pursuant to a sub-lease agreement entered into with LaunchVision Research Inc. (controlled by a director of the Company), the Company incurred rent expense of \$19,530 which is included in general and administration expense. No amount is owing at December 31, 2004.

This transaction was recorded at its exchange amounts, and took place in the normal course of business.

6. OBLIGATION ON SHARE PURCHASE AGREEMENT

On October 4, 2004, the Company entered into a share purchase agreement to acquire all of the issued and outstanding shares of Stem Cell Therapeutics Inc. ["Stem Cell"] from Transition Therapeutics Inc. ["Transition"], which represents an acquisition of intellectual property. The Company agreed to pay Transition an aggregate purchase price of \$3,500,000. The purchase price is payable in instalments beginning on closing, October 4, 2004, in the amount of \$325,000, and on the anniversary of closing in each of the following four years in the amount of \$475,000, \$400,000, \$650,000 and \$1,650,000, respectively. Except for the initial payment, all subsequent payments may be made, at the Company's election, by either cash or common shares; provided that the Company may only elect to issue common shares as payment for the final instalment if the common shares are at such time listed and posted for trading on a recognized stock exchange. On closing, the certificates representing the Stem Cell shares were placed in escrow subject to the payment in full of the purchase price. As part of the share purchase agreement, the Company is subject to commitments for future royalty payments *[see note 9[d]]*.

As the Company has use of the intellectual property during the instalment period, the commitment to acquire Stem Cell has been recorded as a liability based on the discounted present value of the purchase instalments. The current and long-term portions of the obligation are calculated as follows:

	\$
2005	475,000
2006	400,000
2007	650,000
2008	1,650,000
	3,175,000
Less amount representing deemed interest at 15%	1,088,721
	2,086,279

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Less current portion	162,058
Long term portion	1,924,221

7. INCOME TAXES

Future tax assets are determined based on differences between financial reporting and tax bases of assets and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The reconciliation of income tax attributable to continuing operations computed at the statutory rate to income tax expenses is as follows:

	2004
	\$
Statutory tax rate	33.9%
Expected tax recovery	(322,004)
Add: stock option expense	59,203
	(262,801)
Future tax assets not recorded	262,801

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A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Significant components of the Company's future tax assets as at December 31, 2004 are as follows:

	2004
	\$
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Future tax assets	
Non-capital loss carryforwards	171,327
Scientific research and experimental development pool	69,847
Federal investment tax credit carryforwards	41,208
Carrying value of capital and intangible assets in excess of accounting basis	21,627
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Total future tax assets	304,009
Valuation allowance on future tax assets	(304,009)
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Net future tax assets	—
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As at December 31, 2004, the Company has accumulated tax losses for federal and provincial purposes in Canada. The Company also has unclaimed Canadian federal scientific research investment tax credits. The losses and investment tax credits can be used to offset future years' Canadian taxable income, the benefit of which has not been recorded in the accounts. The tax losses and investment tax credits expire as follows:

	Federal	Investment
	\$	tax credits
		\$
<hr/>		
2014	505,390	41,208
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8. CAPITAL LEASE OBLIGATION

	\$
<hr/>	
2005	3,211
2006	2,408
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	5,619
Less amount representing interest at 14.6%	473
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	5,146
Less current portion	2,803
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	2,343
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9. COMMITMENTS AND CONTINGENCIES

[a] Operating leases

The Company leases office facilities under a 16-month sub-lease expiring December 31, 2005, with minimum future annual lease payment commitment for 2005 of \$45,473.

[b] Service agreements

As at December 31, 2004, the future minimum annual payments under capital equipment service agreements for the next five years and thereafter are as follows:

	\$
2005	—
2006	202
2007	485
2008	485
2009	485
Thereafter	283
	<hr/> 1,940

[c] Research contract

Future expected payments under a research contract with an Alberta based university, which expired February 13, 2005, are as follows:

	\$
2005	21,000
	<hr/> 21,000

[d] Contingency

Pursuant to the share purchase agreement from Transition [see note 6], royalty payments may become due and payable in accordance with this agreement upon realization of sales or licensing of patent rights from intellectual property in the Stem Cell Therapeutics Inc. portfolio. When the Company realizes sales of products or processes, a royalty of 2% of net sales will become payable

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to Transition. In addition, if patent rights are licensed, a royalty of 5% of the consideration for such licenses will become payable.

10. RESEARCH AND DEVELOPMENT PROJECTS

The Company is involved in the research and development of therapeutics involved in the stimulation of stem cells for the treatment of neurological diseases. The following costs have been incurred for research and development work performed to December 31, 2004:

	\$
Research and development expense costs	206,038

All research and development costs incurred to date have been expensed. No revenue has been earned from commercialization of the Company's technology.

11. SHARE CAPITAL

[a] Authorized

The authorized share capital of the Company consists of an unlimited number of common shares, Class B shares and First Preferred shares, in each case without nominal or par value. Common shares are voting, and may receive dividends as declared at the discretion of the directors. Class B shares are non-voting and convertible to common shares at the holder's discretion, on a one-for-one basis. Upon dissolution or wind-up of the Company, Class B shares participate rateably with the Common shares in the distribution of the Company's assets.

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[b] Issued and outstanding

	Number of shares #	2004 \$
Common		
Formation of Company, March 31, 2004	1,000,000	10
Acquisition of intellectual property, April 1, 2004 (i)	3,636,364	18,000
Proceeds from issuance at \$0.025 per share, April 14, 2004	2,000,000	50,000
Proceeds from issuance at \$0.10 per share, June 7, 2004	2,550,000	255,000
Proceeds from issuance at \$0.15 per share, August 19, 2004	4,000,000	600,000
Proceeds from issuance at \$0.25 per share, November 19, 2004	1,000,000	250,000
Options exercised, November 21, 2004 (ii)	800,000	55,000
Conversion of Class B to common, November 19, 2004 (iii)	4,000,000	—
	18,986,364	1,228,010
Class B		
Proceeds from issuance at \$0.025 per share, April 20, 2004	10,800,000	270,000
Conversion of Class B to common, November 19, 2004	(4,000,000)	—
	6,800,000	270,000
Financing Costs	—	(7,417)
Balance, end of period	25,786,364	1,490,593

- (i) On April 1, 2004 3,636,364 Common shares were issued for the acquisition of intellectual property, the value of the shares was based on the fair value of the intellectual property acquired, \$18,000.
- (ii) On November 21, 2004, 600,000 options were exercised at a price of \$0.025 and 200,000 options were exercised at a price of \$0.10. In addition, contributed surplus of \$20,000 was reclassified to share capital upon exercise of the options.
- (iii) On November 19, 2004, 4,000,000 Class B shares were converted to 4,000,000 Common shares on a one to one basis.

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[c] Employee stock options

As at December 31, 2004 the Company's Board of Directors has granted 4,725,000 options to employees and directors of the Company to purchase an eligible number of common shares for an exercise price equal to the fair market value of the Company's common shares on the date of the grant as determined by the Board of Directors. The options' term to expiry varies to a maximum of five years from the date of grant. Vesting terms and conditions are determined by the Board of Directors at the time of grant. 800,000 of these options were exercised prior to the filing of a preliminary prospectus.

The following table summarizes the activity of the Company's stock option plan as at December, 2004:

	Number of shares #	Weighted- average exercise price \$
Outstanding, beginning of period	—	—
Granted	4,725,000	0.21
Exercised	800,000	0.044
Cancelled	—	—
Outstanding, end of period	3,925,000	0.25
Options exercisable at period end	3,925,000	0.25

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The following table summarizes information about stock options outstanding as at December 31, 2004:

Range of exercise prices \$	Options outstanding		Options exercisable		
	Options outstanding #	Weighted-average contractual life	Weighted-average exercise price \$	Options exercisable #	Weighted-average exercise price \$
0.25	3,925,000	4.9	\$0.25	725,000	\$0.25

[d] Employee stock options expense

As at December 31, 2004 the Company's Board of Directors has granted a total of 4,725,000 options to employees and directors of the Company to purchase an eligible number of common shares for an exercise price equal to the fair market value of the Company's common shares on the date of the grant as determined by the Board of Directors. These options were granted in April 2004, June 2004, and November 2004 and have been valued using the fair value methodology of the Black-Scholes model.

Date Granted	Strike Price	Share Price	Number of Options	Expected Life	Value per Share ⁽¹⁾	Total Value
April 2004	\$0.025	\$0.025	600,000	0.6 years ⁽²⁾	\$0.02	\$12,000
June 2004	\$0.10	\$0.10	200,000	0.4 years ⁽³⁾	\$0.08	\$16,000
November 2004	\$0.25	\$0.25	3,925,000	5 years	\$0.19	\$745,750 ⁽⁴⁾

- (1) Other weighted-average assumptions were: the risk free interest rate was set at 5%, volatility, although the stock was not publicly traded at that time, was set at 100%, and a dividend yield of nil.
- (2) The expected life was estimated at 0.6 years due to the options expiring upon filing of a preliminary prospectus.
- (3) The expected life was estimated at 0.4 years due to the options expiring upon filing of a preliminary prospectus.
- (4) A total aggregate value of \$137,750 for the options granted to directors (which vested upon granting) and \$608,000 for the options granted to officers, which vest 1/6 after 6 months, and 1/36 every month after for three years. Options granted to directors is

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booked as an expense immediately upon grant (November 2004), whereas options granted to the officers is booked equally over the 36 month vesting period.

12. STATEMENT OF CASH FLOWS

[a] Non-cash transactions

The statement of cash flows excludes the following non-cash transaction:

- the purchase of intellectual property on April 4, 2004 for shares valued at \$18,000.

[b] Interest paid and classified as operating activities is nil.

13. SEGMENTED INFORMATION

Management has determined that the Company operates in one reportable segment based on the nature of the Company's service offerings, types of customers and the method used to deliver its services and the economic characteristics of its operations. This reportable segment involves the research and development of therapeutics involved in the stimulation of stem cells for the treatment of neurological diseases.

The Company's operations are located in Canada.

14. SUBSEQUENT EVENTS

[a] Prospectus

The Company closed its initial public offering on January 6, 2005 and began trading on the TSX-Venture exchange under the symbol SSS on January 11, 2005. 34,000,000 common shares were issued from treasury at \$0.25 per share ["Offering"]. An underwriters' commission of 9% of the aggregate gross proceeds realized from the Offering with expenses resulted in net proceeds of \$7,640,453 to the company.

[b] Options granted

On February 10, 2005, 800,000 stock options were granted to a new officer at an exercise price of \$0.35 per share, vesting over three years with similar vesting provisions as other officers, and with an expiry date of five years after grant.