Corporate Profile

BELLUS Health is a global health company focused on the development and commercialization of products to provide innovative health solutions to address critical unmet needs. Our pharmaceutical strategy includes the development of investigational product candidates for the treatment of Amyloid A amyloidosis, Type II diabetes and certain features of metabolic syndrome, and Alzheimer's disease. BELLUS Health's wholly owned subsidiary, OVOs Natural Health Inc., is engaged in the research, development and commercialization of branded natural health products.

2009

Bellus Health Annual Report

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Bellus HEALTH

Dear Shareholders,

During a challenging 2009 for the biotech industry in North America, BELLUS Health earned some hard-fought victories. We continued to develop our most promising products in 2009. We raised additional equity capital in a market environment that was very difficult for the biotechnology industry and we evolved our governance and management teams to provide for succession to Dr. Francesco Bellini. As we move into 2010, BELLUS Health is a leaner, more focused organization. We have a new business plan focused on product development in partnership with strong industry players.

In an economic environment during 2009 that was extremely difficult for even the most established industries, the capital-intensive Canadian biotechnology industry continued to be heavily damaged by the financial crisis. The industry's difficulties in accessing capital markets continued to endure well after the economy had started showing signs of recovery. The consequences are clear for those Canadian biotech companies that did not survive the financial crisis.

BELLUS Health experienced similar difficulties and we moved decisively to ensure continuity. To protect shareholder value, significant steps were taken in the first half of the year to reduce the Company's burn rate. Significant cuts were made in basic research, support and administrative functions and significant financial concessions were agreed upon with our landlord and noteholders. All of this was accomplished without affecting existing product and product candidates. These actions were a necessary step in enabling us to attract new capital at a juncture when capital was extremely scarce. Indeed, we attracted more than CDN$30 million in new capital through an issue of convertible notes and a rights offering to shareholders.

The challenges that we faced in fiscal year 2009 also led us to revisit our business model and define a new vision for the Company. Leveraging its know-how and expertise in the development of biotech assets, BELLUS Health will henceforth focus on what we do best: taking early-stage product candidates that address unmet medical needs and developing these products through proof-of-concept Phase II studies. Strategic partnerships will then be entered into to conduct large Phase III clinical trials and undertake commercial activities. We strongly believe that this new vision will best harness the Company's competitive advantage and successfully unlock value for our shareholders. In pursuing these important objectives, we remain extremely cost-conscious.

The key decisions and initiatives we took in 2009 are the foundation on which we are building value for the products in our pipeline. To achieve this objective, the Company is fortunate to count on a well balanced pipeline of products composed of both early-stage products for prominent indications such as Alzheimer's disease and Type II diabetes, and late-stage products with commercial value.

- KIACTA™ - BELLUS Health is developing this product for the treatment of Amyloid A amyloidosis. We have completed a first Phase III clinical trial. Discussions are ongoing with several potential partners to conduct the confirmatory Phase III clinical trial, the last step prior to commercialization of the product. Our objective is to start this confirmatory Phase III clinical trial in the second half of 2010.
- NC-503 (eprodisate) - We are hopeful that the results of the Phase II clinical trial recently conducted will be positive. This study may serve as a clinical proof-of-concept to support the development program of a pro-drug of NC-503 for the treatment of Type II diabetes.

- NRM8499, a prodrug of tramiprosate - The tramiprosate development program allowed us to gain unequalled knowledge about this compound as well as a deep understanding of Alzheimer's disease. We believe this experience provides us an important advantage in potentially developing an effective treatment for Alzheimer's disease. The Phase I study of NRM8499 began on March 30th, 2010 and is expected to conclude in the second half of 2010.
- VIVIMIND™ – This natural product, which is already helping to protect memory function for many Canadians, received regulatory approval for sale in both Italy and Spain in 2009. We are currently in discussions with potential partners to oversee the global commercial activities of the product.

In 2009, we embraced each challenge we faced and we found our way through it. With a leaner and more efficient structure, a promising pipeline of products and a new business plan, BELLUS Health is now more strongly positioned for the future.

Many people showed us their strong support this past year and we owe them a debt of gratitude. In particular, I would like to thank our shareholders for their continued commitment and support. To each of our employees, thank you for your patience and support during 2009. Finally, to the members of our Board of Directors, past and present, our sincerest thank you for your guidance and support as we tackled the challenges together and put in place a new plan for the Company. To shareholders, employees and Directors, 2010 is a new year full of promise and the Company counts on your continued support to ensure its success.

I would like to express a special thank-you to Dr. Francesco Bellini, who as President and CEO of BELLUS Health until the start of this year, took the necessary decisions that would ensure this company not only survives but also flourishes. Dr. Bellini is staying on as Chairman of the Board of Directors, and he will continue providing us with his wisdom and expertise as BELLUS Health moves into this new phase of development and growth.

I look forward to working with you to realize the execution of our plan and our success.

Sincerely,

Roberto Bellini

President and Chief Executive Officer

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MANAGEMENT'S DISCUSSION AND ANALYSIS

BELLUS Health Inc. and its subsidiaries (BELLUS Health or the Company) is a global health company focused on the development and commercialization of products to provide innovative health solutions to address critical unmet needs. The Company's shares trades on the Toronto Stock Exchange (TSX) under the symbol BLU.

The Management's Discussion and Analysis (MD&A) provides a review of the Company's operations and financial performance for the years ended December 31, 2009 and 2008. It should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2009, which have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Additional information relating to the Company, including its Annual Report and Annual Information Form, as well as registration statements and other public filings, is available on SEDAR at www.sedar.com

This document contains forward-looking statements, which are qualified by reference to, and should be read together with the "Forward-Looking Statements" cautionary notice, which can be found at the end of this MD&A.

All currency figures reported in the consolidated financial statements and in this document, including comparative figures, are reported in US dollars, unless otherwise specified.

This MD&A was prepared by Management with information available as at February 23, 2010.

BUSINESS OVERVIEW

During the year, the Company raised more than CDN$30 million with the issuance of CDN$20.5 million convertible notes in April and June 2009, and a rights offering totalling approximately CDN$9.7 million in September 2009 (see Liquidity and capital resources section for further details).

In addition, BELLUS Health took significant steps to reduce its burn rate. In April 2009, the Company restructured the convertible notes due in 2026 and 2027, as well as the lease of the Company's main premises in Laval, Quebec, resulting in annual cash savings of approximately $4.7 million. Also in March 2009, the Company announced the reduction of its workforce by approximately 45%. The programs related to the Company's existing product and product candidates were not affected by the cuts, which were being made primarily in basic research and research-related functions, as well as support and administrative functions.

The current status of the Company's principal pharmaceutical product candidates is as follows:

Disease indication	Product candidate	Stage of development
Amyloid A (AA) amyloidosis	eprodisate (KIACTA™)	Phase III clinical trial
Type II diabetes and certain features of metabolic syndrome	NC-503 (eprodisate)	Phase II clinical trial
Alzheimer's disease	prodrug of tramiprosate	Preclinical development
Type II diabetes and certain features of metabolic syndrome	prodrug of NC-503	Research

Eprodisate (KIACTA™) is the Company's oral investigational product candidate for the treatment of AA amyloidosis, a potentially fatal disease which is often associated with kidney dysfunction. In 2008, the Company announced its decision to continue the drug development program for eprodisate (KIACTA™) and that it planned to initiate a second Phase III clinical trial for eprodisate (KIACTA™) in close cooperation with the US Food and Drug Administration (FDA) and the European Medicines Agency (EMEA). The Company is currently involved in discussions with different parties to secure agreements in relation to the continued development (including the second Phase III trial) and commercialization of eprodisate (KIACTA™).

Prior to 2008, the Company was seeking marketing approval of eprodisate (KIACTA™) for the treatment of AA amyloidosis, following the initial Phase II/III clinical trial previously completed. In an approvable letter received in July 2007 from the FDA, it was indicated that an additional efficacy trial will be necessary before the FDA could approve the investigational product candidate. BELLUS Health had also filed for marketing approval of eprodisate (KIACTA™) for the treatment of AA amyloidosis in the European Union and Switzerland. In December 2007, the Committee for Medicinal Products for Human Use (CHMP), the scientific committee of the EMEA, also concluded that another study would be needed to confirm the effectiveness of eprodisate (KIACTA™). Accordingly, the Company withdrew its marketing applications for eprodisate (KIACTA™) in the US, the European Union and Switzerland. Eprodisate (KIACTA™) has been granted Orphan Drug Designation in the US and received Orphan Medicinal Product designation in Europe, which normally provide for market exclusivity of seven years and ten years, respectively, once the drug is approved. Eprodisate (KIACTA™) has also received Orphan Drug Designation in Switzerland.

The Company is also investigating the efficacy of NC-503 (eprodisate) for the treatment of Type II diabetes and certain features of metabolic syndrome. During the second quarter of 2008, a Phase II clinical trial in diabetic patients was initiated in Canada. The study is a randomized 26-week, double-blind, placebo-controlled study. The Company expects to release the final results of the Phase II clinical trial in the first half of 2010. Results from a validated rat model of diabetes and metabolic syndrome have demonstrated that NC-503 decreases glucose, cholesterol and triglycerides blood levels in obese diabetic Zucker rats, when compared to the control group, while preserving 40% more pancreatic islet cells (insulin secreting cells) as compared to the control group, and have shown some protective effect on renal function. This study will serve as clinical proof-of-concept to support the development program of a prodrug of NC-503 for the treatment of Type II diabetes and certain

features of metabolic syndrome which is expected to enter into preclinical development in the second half of 2010.

In addition, the Company is developing a prodrug of tramiprosate (ALZHEMED™; homotaurine) for the treatment of Alzheimer's disease (AD) and it is expected that the Company will initiate a Phase I clinical trial during the first half of 2010. The cost of this Phase I clinical trial is expected to approximate $1.0 million. Following the termination of the tramiprosate (ALZHEMED™; homotaurine) pharmaceutical drug development program for the treatment of AD in 2007, the Company took the decision to leverage the numerous years of accumulated knowledge and experience it has gained in developing tramiprosate (ALZHEMED™) for AD, and to prioritize the development of its next generation prodrug candidate of tramiprosate into preclinical development for the treatment of AD.

Given the early stage of the Company's pharmaceutical product candidates (namely tramiprosate and NC-503 prodrugs), it is impossible to outline the nature, timing or estimated costs necessary to complete these projects, nor the anticipated completion dates for these projects. The facts and circumstances indicating the uncertainties that preclude the Company from making a reasonable estimate of the costs and timing necessary to complete projects include the risks inherent in any clinical trials, the uncertainty as to the nature and extent of regulatory requirements both for safety and efficacy, and the ability to manufacture the products in accordance with current good manufacturing requirements and in sufficient quantities both for large scale trials and for commercial use.

In September 2008, the Company launched its first product, VIVIMIND™ (tramiprosate; homotaurine), in Canada and globally on the Internet. VIVIMIND™ is a natural health brand designed to protect memory function and is based on homotaurine, a naturally occurring ingredient found in certain seaweed. VIVIMIND™ is the direct result of over 15 years of significant scientific research, including clinical testing in over 2,000 individuals. Results outlining the beneficial effects of homotaurine were published in the June 2009 edition of the Journal of Nutrition, Health and Aging, the peer-reviewed journal of the European Union Geriatric Medicine Society. The results show that homotaurine slows the loss of volume in the hippocampus, a region of the brain associated with memory, and suggests that homotaurine has a beneficial effect on cognition. A second scientific article on the results of the North American clinical Phase III study of homotaurine has recently been published in the Journal of Nutrition Health and Aging (JNHA 2009; 13 (9):808-12), revealing statistically significant differences or statistical trends in favour of homotaurine on six ADAS-cog subscales which measures memory function, language skills and praxis (planning and execution) abilities. On the regulatory front, the Company continues to move forward on its original goal of making VIVIMIND™ available on a worldwide basis. On July 16, 2009, the Company announced that the Italian Ministry of Health had granted a certificate of free sale for VIVIMIND™ as a food supplement, permitting the commercial sale of the product in that country. This certificate opens up means by which to pursue marketing and sales authorization in the other member states of the European Union. With respect to the United States, the Company has filed a premarket notification of a New Dietary Ingredient for homotaurine with the FDA, and is pursuing mandatory associated regulatory activities to obtain marketing approval for homotaurine as a dietary supplement. In January 2010, the National Association of Pharmacy Regulatory Authorities (NAPRA) issued a directive to provincial pharmacists associations requesting that pharmacists not sell natural health products that have not been issued a Natural Health Product Number (NPN) by Health Canada. The Company has taken a decision to temporarily cease its sales and marketing activities for VIVIMIND™

until a NPN number has been received for the product, expected in the middle of 2010. The Company plans on re-launching the product in Canada at that time. In the meantime, the product will still be available via the Internet. This decision does not have a significant impact on the consolidated financial statements.

On July 17, 2008, the Company acquired 100% of the remaining outstanding capital stock that it did not already own of Innodia Inc. (Innodia), a private company engaged in developing compounds for the treatment of diabetes, obesity and related metabolic conditions and diseases. Prior to the acquisition, the Company indirectly held 23% of Innodia's capital stock. The Company acquired all of the operations of Innodia, including the intellectual property assets related to its diabetes and obesity projects. As a result of the transaction, the Company also regained exclusive rights to its own diabetes platform and all related compounds. The purchase price, in the amount of $1,278,000, was settled by the issuance from treasury of 1,185,797 common shares of the Company. In July 2009, it was determined that the additional consideration that was conditionally payable on the first anniversary of the closing of the transaction, based on the value at that time of the Innodia investment in asset-backed commercial paper, was nil.

On January 8, 2009, the Company's common stock was delisted from the NASDAQ Capital Market following the Company's formal notice to the NASDAQ Stock Market of its intention to voluntarily delist its common stock. The Company's listing on the TSX was not affected by the delisting from NASDAQ.

As at December 31, 2009, the major shareholders of the Company are Victoria Square Ventures Inc. (VSVI), a subsidiary of Power Corporation of Canada, and Vitus Investments III Private Limited (Vitus) a corporation whose shares are beneficially owned by Mr. Carlo Bellini, which held approximately 26% and 20%, respectively, as of that date, based on the issued and outstanding shares of the Company.

On December 15, 2009, the Company announced that Mr. Roberto Bellini had been named President and Chief Executive Officer of the Company, effective January 1, 2010. As previously announced at the annual general meeting of shareholders in June 2009, Dr. Francesco Bellini stepped down as President and Chief Executive Officer of the Company effective December 31, 2009. Dr. Francesco Bellini remains Chairman of the Board of Directors and will also provide ongoing advisory services to the Company, thus enabling BELLUS Health to continue to benefit from his vast expertise and knowledge of the health sciences and the pharmaceutical industries. The Company also announced that Mr. Charles Cavell, who was elected to the BELLUS Health Board of Directors at the annual general meeting in June 2009, had agreed to assume the responsibility of Deputy Chairman, effective January 1, 2010.

The Company has significant tax losses that may be used to reduce future taxable income. See note 15 of the Consolidated Financial Statements for more details.

As at December 31, 2009, BELLUS Health's workforce comprised 55 employees, compared to 104 employees as at December 31, 2008, following the reduction of the Company's workforce in March 2009, as previously discussed.

Financial position and going concern

To date, the Company has financed its operations primarily through public offerings of common shares, private placements, issuance of convertible notes, as well as a sale-leaseback transaction, research tax credits, collaboration and research contracts, interest and other income. The future operations and profitability of the Company is dependent upon such factors as the success of the clinical trials, the approval by regulatory authorities of products developed by the Company, the ability of the Company to successfully market, sell and distribute products, including its natural health products, and the ability of the Company to obtain the necessary financing to complete its projects. In January 2009, the Company delisted its shares from NASDAQ. Additionally, in May 2009, the Company deregistered its securities from the Securities Exchange Commission (SEC). The Company's shares trade on the TSX.

The Company has incurred significant operating losses and negative cash outflows from operations since inception and has an accumulated deficit of $383,607,000 as at December 31, 2009. As at that date, the Company had cash and cash equivalents in the amount of $13,393,000. As at February 23, 2010, the Company had cash and cash equivalents in the amount of $11,565,000. The Company's burn rate for the quarter ended December 31, 2009 amounted to $4.9 million. The burn rate of the upcoming quarters is dependent upon the level of research and development activities in relation to the Company's product candidates; however the burn rate can be reduced in the event of a change in planned research and development activities.

As at December 31, 2009, the Company's committed cash obligations and expected level of expenses for the upcoming twelve months exceed the committed sources of funds and the Company's cash and cash equivalents on hand. The ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through collaborative research contracts, distribution agreements or product licensing agreements, sales with respect to its businesses, and ultimately, from obtaining regulatory approval in various jurisdictions to market and sell its product candidates and ultimately achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company's control. These factors raise significant doubt about the Company's ability to continue as a going concern beyond 2010.

Management continues to actively pursue additional sources of funds. The Company is currently involved in ongoing discussions with several parties to secure partnership agreements, collaboration agreements, licensing agreements and/or sales with respect to its businesses, product or product candidates. While the discussions could lead to the signing of binding agreements in the future, there can be no assurance whatsoever that any such transaction will be put in place. As a result, there is material uncertainty as to whether the Company will have the ability to continue as a going concern beyond 2010 and thereby realize its assets and discharge its liabilities in the normal course of business.

The consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. The financial statements do not include any adjustments to the carrying value and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to find a buyer with respect to its businesses, to receive significant funds on signing collaborative research and development contracts, distribution agreements or by out licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes, would be reduced to liquidation value.

Selected Financial information

(In thousands of US dollars, except per share data)

	Years ended December 31		
	2009	2008	2007
Revenues:			
Net sales	(116)	310	-
Collaboration agreement	-	205	1,119
Reimbursable costs	-	69	396
	(116)	584	1,515
Expenses:			
Research and development	11,213	25,027	55,732
Research tax credits and grants	(1,171)	(1,430)	(2,161)
	10,042	23,597	53,571
General and administrative	6,265	12,605	11,817
Marketing and selling	3,709	6,661	-
Reimbursable costs	-	69	396
Stock-based compensation	2,301	2,309	4,275
Depreciation of equipment	693	870	1,034
Net credit for vacant space	(2,009)	-	-
	21,001	46,111	71,093
Loss before undernoted items	(21,117)	(45,527)	(69,578)
Interest income	102	907	3,341
Interest and bank charges	(324)	(271)	(202)
Accretion expense	(5,198)	(4,937)	(15,751)
Change in fair value embedded derivatives	41	86	(870)
Gain on extinguishment of debt	17,020	-	-
Change in fair value of New ABCP Notes	269	309	(1,184)
Foreign exchange (loss) gain	(434)	287	1,130
Other Income	1,414	1,051	1,274
Share of loss in a company subject to significant influence	-	-	(327)
Non-controlling interest	-	-	109
Net Loss	(8,227)	(48,095)	(82,058)

Selected Financial information (continued)

(In thousands of US dollars, except per share data)

	December 31, 2009	December 31, 2008	December 31, 2007
Net loss per share – Basic	(0.06)	(0.97)	(1.86)
Net loss per share – Diluted	(0.17)	(0.97)	(1.86)
Total assets	28,026	26,416	72,275
Total long-term liabilities	36,185	63,211	52,602

RESULTS OF OPERATIONS

Year ended December 31, 2009, compared to the year ended December 31, 2008

Gross sales amounted to $321,000 for the year ended December 31, 2009, compared to $423,000 for the previous year. Net sales amounted to negative $116,000 for the year ended December 31, 2009, compared to $310,000 for previous year. These sales represent the sales of VIVIMIND™ (also known as tramiprosate and homotaurine), the Company's first natural health brand launched in September 2008, in Canada and also globally on the Internet. The decrease in net sales for the year ended December 31, 2009, compared to the previous year is mainly attributed to provisions year following the Company's decision to reduce the price of VIVIMIND™ effective July 7, 2009, and the Company's estimate of potential expired products to be returned in the first half of 2010. The decision to reduce the price of VIVIMIND™ was supported by changing economic conditions, as well as comments from consumers, healthcare providers and retail customers.

Research and development expenses, before research tax credits and grants, amounted to $11,213,000 for the year ended December 31, 2009, compared to $25,027,000 for the previous year. The decrease is mainly attributable to a reduction in expenses incurred in relation to the wind-down of the Phase III study to the development of tramiprosate (ALZHEMED™; homotaurine) for the treatment of AD, following the Company's decision in November 2007 to terminate the tramiprosate (ALZHEMED™) pharmaceutical drug development program.

Research tax credits and grants amounted to $1,171,000 for the year ended December 31, 2009, compared to $1,430,000 for the previous year. Research tax credits represent refundable tax credits earned under the Quebec Scientific Research and Experimental Development Program for expenditures incurred in Quebec. The research tax credits recorded are management's belief for which there is reasonable assurance of collection. Research tax credits claimed for current and prior years are subject to current government review which could result in adjustment to earnings.

General and administrative expenses totalled $6,265,000 for the year ended December 31, 2009, compared to $12,605,000 for the previous year. Expenses for the current year are presented net of an amount of $4,071,000 in relation to amortization of the deferred gain on sale of property compared to $1,339,000 for the corresponding period the previous year. The decrease is also due to a reduction in the workforce during the first quarter ended March 31, 2009, as well as other additional measures implemented by the Company to reduce its burn rate.

Marketing and selling expenses amounted to $3,709,000 for the year ended December 31, 2009, compared to $6,661,000 for the previous year and represent expenses incurred in relation to the commercialization of the Company's natural health brand, VIVIMIND™. The decrease is due to a reduction in marketing activities during the current year, compared to the previous year, during which the product was launched.

Stock-based compensation amounted to $2,301,000 for the year ended December 31, 2009, compared to $2,309,000 for the previous year. This expense relates to stock options and stock-based incentives, whereby compensation cost in relation to stock options is measured at fair value at the date of grant and is expensed over the award's vesting period.

Net credit for vacant space amounted to $2,009,000 and is in relation to the vacancy of a portion of the Company's premises following the reduction in the Company's research activities and associated workforce. Refer to Liquidity and Capital resources section for details.

Interest income amounted to $102,000 for the year ended December 31, 2009, compared to $907,000 for the previous year. The decrease is mainly attributable to lower average cash balances and lower interest rates during the current year compared to the previous year.

Accretion expense amounted to $5,198,000 for the year ended December 31, 2009 compared to $4,937,000 for the previous year. Accretion expense represents the imputed interest under GAAP on the 2006, 2007 and 2009 convertible notes, and liability portion of the preferred shares. The Company accretes the carrying values of these items to their face values through a charge to earnings over their expected lives. As of December 31, 2009, the face value in the amount of $13,000,000 of the Amended 2006 Notes, $500,000 of the Amended 2007 Notes and CDN$21,115,000 of the 2009 Notes remained outstanding.

Gain on extinguishment of debt amounted to $17,020,000 and resulted from amendments to the terms of the 2006 and 2007 Notes that took place at the time of a refinancing of the Company in April 2009. Refer Liquidity and Capital Resources section for details.

Change in fair value of New Asset-Backed Commercial Paper (ABCP) *Notes* increased by $269,000 for the year ended December 31, 2009, compared to an increase of $309,000 for the previous year. This represents net changes during the periods on the valuation of New ABCP Notes held by the Company. Refer to the Liquidity and Capital Resources section for details.

Foreign exchange loss amounted to $434,000 for the year ended December 31, 2009, compared to a gain of $287,000 for the previous year. Foreign exchange gains or losses arise on the movement in foreign exchange rates in relation to the Company's net monetary assets denominated in currencies other than US dollars, the Company's functional and reporting currency, such net monetary assets consisting primarily of assets and liabilities denominated in CDN dollars. Foreign exchange gains for the comparative year include $924,000 of gain recognized on the reclassification of the refundable amount ($6,000,000) due to Centocor, Inc., from deferred revenue (non-monetary liability) to accrued liability (monetary liability) following the recovery by the Company of ownership rights in and control of eprodisate (KIACTA™). Refer to the Critical Accounting Policies and Estimates for details on the Company's decision to convert to the CDN dollar as its functional currency, effective January 1, 2010.

Other income amounted to $1,414,000 for the year ended December 31, 2009, compared to $1,051,000 for the previous year. Other income consists of non-operating revenue, such as sublease revenue and other items. The increase is mainly attributable to a gain realized on the settlement of a dispute with a supplier.

Year ended December 31, 2008, compared to the year ended December 31, 2007

Net sales amounted to $310,000 for the year ended December 31, 2008, and represent the initial sales of VIVIMIND™, the Company's first natural health brand launched in Canada and globally on the Internet on September 2, 2008.

Revenue from collaboration agreement amounted to $205,000 for the year ended December 31, 2008, compared to $1,119,000 for the previous year. This revenue was earned under the agreement with Centocor in respect of eprodisate (KIACTA™), an oral investigational product candidate for the treatment of AA amyloidosis. On April 15, 2008, the Company announced that it had regained full ownership rights and control of eprodisate (KIACTA™) from Centocor. During the second quarter of 2008, the refundable portion ($6,000,000) of the upfront payment received from Centocor in 2005 was refunded to Centocor.

Research and development expenses, before research tax credits and grants, amounted to $25,027,000 for the year ended December 31, 2008, compared to $55,732,000 for the previous year. The decrease is mainly attributable to a reduction in expenses incurred in relation to the development of tramiprosate (ALZHEMED™; homotaurine) for the treatment of AD, following the Company's decision in November 2007 to terminate the tramiprosate (ALZHEMED™) pharmaceutical drug development program.

Research tax credits and grants amounted to $1,430,000 for the year ended December 31, 2008, compared to $2,161,000 for the previous year. Research tax credits represent refundable tax credits earned under the Quebec Scientific Research and Experimental Development Program for expenditures incurred in Quebec. The decrease is mainly attributable to lower research and development expenses incurred in Quebec during the current period that are eligible for refundable tax credits.

General and administrative expenses totalled $12,605,000 for the year ended December 31, 2008, compared to $11,817,000 for the previous year. The increase is mainly due to expenses incurred in relation to the initiation of the Company's natural health product activities in 2008.

Marketing and selling expenses amounted to $6,661,000 for the year ended December 31, 2008, and represent expenses incurred in relation to the commercialization of the Company's natural health brand, VIVIMIND™, which was launched during the third quarter of 2008.

Stock-based compensation amounted to $2,309,000 for the year ended December 31, 2008, compared to $4,275,000 for previous year. The decrease is mainly due to adjustments in relation to forfeiture of stock options during 2008, which occurred as a result of reductions in the workforce.

Interest income amounted to $907,000 for the year ended December 31, 2008, compared to $3,341,000 for the previous year. The decrease is mainly attributable to lower average cash balances and lower interest rates during the current year, compared to the previous year.

Accretion expense amounted to $4,937,000 for the year ended December 31, 2008, compared to $15,751,000 for the previous year. Accretion expense represents the imputed interest under GAAP on the 2006 and 2007 convertible notes. The decrease is mainly due to accretion expenses of

$10,430,000 recorded during 2007 on the 2007 5% senior subordinated convertible notes issued in May 2007, which were fully converted during that year.

Change in fair value of embedded derivatives amounted to a gain of $86,000 for the year ended December 31, 2008, compared to a loss of $870,000 for the previous year and represents the variation in the fair value of the embedded derivatives, including the embedded derivative related to the $80,000,000 aggregate principal amount of Senior and Junior Notes issued in May 2007.

Change in fair value of ABCP increased by $309,000 for the year ended December 31, 2008, compared to a decrease of $1,184,000 the previous year and represents adjustments recorded on the valuation of ABCP held by the Company. The increase recorded during 2008 is due to increased valuation of certain assets recognized as part of the Innodia transaction. See the Liquidity and Capital Resources section for more details.

Foreign exchange gain amounted to $287,000 for the year ended December 31, 2008, compared to a gain of $1,130,000 for the previous year. Foreign exchange gains or losses arise on the movement in foreign exchange rates in relation to the Company's net monetary assets denominated in currencies other than US dollars, which is its functional and reporting currency, and consists primarily of monetary assets and liabilities denominated in Canadian dollars. Foreign exchange gains for 2008 include $924,000 of gains recognized on the reclassification of the refundable amount ($6,000,000) due to Centocor, during the first quarter of 2008, from deferred revenue (non-monetary liability) to accrued liability (monetary liability), following the recovery by the Company of ownership rights and control of eprodisate (KIACTA™).

Other income amounted to $1,051,000 for the year ended December 31, 2008, compared to $1,274,000 for the previous year. Other income consists of non-operating revenue, primarily sublease revenue.

Net loss for the year ended December 31, 2008, amounted to $48,095,000 ($0.97 per share), compared to $82,058,000 ($1.86 per share) for the previous year.

Fourth quarter (unaudited)

For the fourth quarter ended December 31, 2009, the Company recorded a *net loss* of $5,360,000 ($0.03 per share), compared to $11,136,000 ($0.22 per share) for the corresponding quarter the previous year.

Gross sales amounted to $49,000 for the quarter ended December 31, 2009, compared to $217,000 for the corresponding quarter the previous year. *Net sales* for the quarter ended December 31, 2009, amounted to negative $110,000, compared to $157,000 for the corresponding quarter the previous year. The decrease in net sales is mainly attributable to a provision in relation to the Company's estimate of potential expired products to be returned in the first half of 2010, compared to the prior year quarter, which was the first complete quarter the product was launched.

Research and Development expenses, before tax credits and grants, amounted to $2,578,000 for the quarter ended December 31, 2009, compared to $3,916,000 for the corresponding quarter the previous year. The decrease is mainly attributable to a reduction in the Company's research and development activities.

General and administrative expenses totalled $526,000 for the quarter ended December 31, 2009, compared to $3,456,000 for the corresponding quarter the previous year. Expenses for the current quarter are presented net of an amount of $1,245,000 in relation to amortization of the deferred gain on sale of property, compared to $335,000 for the corresponding period the previous year. The decrease is also due to a reduction in the workforce during the first quarter ended March 31, 2009, as well as other additional measures implemented by the Company to reduce its burn rate.

Marketing and selling expenses amounted to $426,000 for the quarter ended December 31, 2009 compared to $3,202,000 for the corresponding quarter the previous year, and represent expenses incurred in relation to the commercialization of the Company's natural health brand, VIVIMIND™, which was launched during the third quarter of 2008. The decrease is due to a reduction in marketing activities during the current quarter, compared to the same quarter in 2008, year during which the product was launched.

Stock-based compensation amounted to $363,000 for the quarter ended December 31, 2009, compared to $11,000 for the corresponding quarter the previous year. The increase is mainly due to adjustments in relation to the estimate of the forfeiture rate of stock options in the prior year period.

Interest income amounted to $30,000 quarter ended December 31, 2009, compared to $51,000 for the corresponding quarter the previous year. The decrease is mainly attributable to lower interest rates during the current quarter, compared to the same quarter in the previous year.

Change in fair value of New ABCP Notes decreased by $231,000 for the quarter ended December 31, 2009, compared to an increase of $684,000 for the corresponding quarter the previous year. This represents adjustments recorded on the valuation of New ABCP Notes held by the Company.

Quarterly results (unaudited)
(*in thousands of US dollars, except per share data)*

Quarter	Net Revenue	Net (loss) income	Basic net (loss) income per share	Diluted net loss per share
	$	$	$	$
Year ended December 31, 2009				
Fourth	(110)	(5,360)	(0.03)	(0.03)
Third	99	(5,840)	(0.04)	(0.04)
Second	(189)	12,880	0.10	(0.03)
First	84	(9,907)	(0.20)	(0.20)
Year ended December 31, 2008				
Fourth	157	(11,136)	(0.22)	(0.22)
Third	153	(11,175)	(0.22)	(0.22)
Second	47	(12,742)	(0.26)	(0.26)
First	227	(13,042)	(0.27)	(0.27)

The 2008 comparative quarterly net losses and net losses per share have been recast following the adoption on January 1, 2009, of a new accounting standard for goodwill and intangible assets. Refer to note 3(a) of the Consolidated Financial Statements.

Compared to the corresponding quarter the previous year, the decrease in quarterly net losses is primarily due to a reduction in research and development expenses. In addition, the decrease in the fourth quarter ended December 31, 2009 is also due to a reduction in marketing activities in relation to VIVIMIND^{TM} as well as other additional measures implemented by the Company to reduce its burn rate. Net income for the quarter-ended June 30, 2009, includes a gain on extinguishment of debt in the amount of $17,020,000 and a net credit for vacant space in the amount of $2,196,000.

Related party transactions

(In thousands of US dollars)

	Year ended December 31, 2009	Year ended December 31, 2008	Year ended December 31, 2007
Management services expense	1,568	2,360	2,343

In March 2003, BELLUS Health entered into a management services agreement with Picchio International Inc. (Picchio International) into which Picchio Pharma Inc. intervened, which was subsequently amended. Picchio International is wholly-owned by Dr. Francesco Bellini and his spouse. The management services agreement stipulates that Picchio International provide the services of Dr. Francesco Bellini, as Chief Executive Officer of the Company and services of other members of Picchio International and Picchio Pharma Inc. Under the agreement, Picchio International and Picchio Pharma Inc. provide regular consulting and advisory services, including services related to reviewing existing and potential research and development activities, and potential clinical programs, financing activities, partnering and licensing opportunities, commercialization plans and programs, and advising and assisting in investor relations activities. In consideration of all services rendered under the agreement, Picchio International received a monthly fee of approximately CDN$208,000 in 2008 and a portion of 2009. The management services agreement was amended in June 2009 whereby a portion of the management fee was settled in Deferred Share Units (DSUs) ($669,000 for the year ended December 31, 2009). See note 11(g) of the Consolidated Financial Statements, for the terms of these DSUs. The management services agreement with Picchio International expired on December 31, 2009, which corresponded with Dr. Francesco Bellini's retirement as President and Chief Executive Officer, previously announced at the annual general meeting of shareholders in June 2009. Dr. Francesco Bellini remains Chairman of the Board of Directors and will also provide ongoing advisory services to the Company under the terms of a new consulting and services agreement between the Company and Picchio International. Picchio International will receive a monthly fee of CDN$20,833, plus applicable expenses for services rendered under the agreement. The agreement has a one year term and shall renew for successive one year terms.

In 2004, the Company entered into an agreement to issue shares with Dr. Francesco Bellini. Refer to the Contractual Obligations section for details.

Please refer to notes 13(b) of the Consolidated Financial Statements for transactions with Parteq Research and Development Innovations.

FINANCIAL CONDITION

Liquidity and capital resources

As at December 31, 2009, the Company had available cash and cash equivalents of $13,393,000, compared to $10,595,000 at December 31, 2008. The increase is primarily due the completion of the CDN$9.7 million rights offering in September 2009 and the CDN$20.5 million convertible notes financing in April 2009, discussed below, which amounts were partially spent to fund operating activities.

During the past year, capital markets have been characterized by significant volatility and by a marked reduction in the ability of companies, including biotechnology companies, to access markets for financing. In light of these conditions and given the Company's current cash position and the requirement to secure additional capital in order to continue its operations, BELLUS Health is continuing to actively pursue additional source of funds. The Company is currently involved in ongoing discussions with several parties to secure partnership agreements, collaboration agreements, licensing agreements and/or sales with respect to its businesses, product or product candidates. While the discussions could lead to the signing of binding agreements in the future, no such transactions have been concluded as of February 23, 2010 and there can be no assurance whatsoever that any such transaction will be put in place. There is significant doubt about the Company's ability to continue as a going concern. For a discussion on the Company's financial position and going concern, refer to the section presented at the end of the Business overview section and to the Liquidity risk section of the Financial risk management discussion below.

Financing activities

On September 10, 2009, the Company completed a CDN$9,687,000 rights offering and issued a total of 52,363,419 common shares at a price of CDN$0.185 per share (the Subscription Price). Under the rights offering, rights were exercised to subscribe for 9,120,177 common shares at the Subscription Price for proceeds of CDN$1,687,000. At the same time, in accordance with the terms of the stand-by purchase agreements entered into by BELLUS Health with Vitus and VSVI (together, the Investors), each of the Investors subscribed for 21,621,621 common shares of BELLUS Health at the Subscription Price for an aggregate of CDN$8,000,000. The Subscription Price represented a 25% discount off the volume weighted average price of the Company's common shares on the TSX during the five trading days immediately preceding the filing of the prospectus on July 15, 2009. The rights offering resulted in the reduction of the conversion price of the 2006 Notes to $16.03 and rendered such notes immediately convertible, resulted in the reduction of the conversion price of the 2009 Notes to CDN$0.185 and the reduction of the exercise price and an increase in the outstanding number of the outstanding warrants issued in connection with the 2007 Notes. Net proceeds of the rights offering were $8,602,000 and as of December 31, 2009, $1,928,000 has yet to be spent. The use of proceeds continues to conform in all material aspects with the expectations set forth in the publicly filed documents.

On April 16, 2009, the Company completed the first tranche of a CDN$20,500,000 convertible notes (2009 Notes) financing with Vitus, and VSVI. On that date, BELLUS Health received gross proceeds of CDN$10,000,000 for the issuance of 2009 Notes (CDN$5,000,000 from each Vitus and VSVI). On June 3, 2009, BELLUS Health received a second tranche of CDN$10,500,000 (CDN$5,000,000 from Vitus and CDN$5,500,000 from VSVI) and issued additional 2009 Notes in consideration for the second tranche principal amount received. The aggregate amount of the 2009 Notes issued to the Investors was increased by CDN$615,000 to cover a set up fee in connection with the financing.

In connection with and as a condition to the 2009 Notes financing, BELLUS Health and all of the existing note holders agreed, in order to reduce cash interest payments, to amend the terms of the outstanding 2006 Notes and 2007 Notes to either make them convertible into a new series of preferred shares of BELLUS Health and to have these notes converted into such preferred shares immediately, or to otherwise amend the existing notes which remained outstanding. In addition, the landlord of BELLUS Health's premises in Laval, Quebec, agreed, as a condition precedent to the financing, to defer certain rental payments and to accept payment at a later date of the deferred rent in cash or common shares of BELLUS Health (at the then applicable market price) at the option of BELLUS Health. The features of the 2009 Notes issued to the Investors, the terms of the preferred shares, the amended terms of the 2006 Notes and 2007 Notes, as well as the amended terms of the lease for the Laval premises are set forth below.

The 2009 Notes are secured, subject to certain permitted encumbrances, by a first charge on all of the assets of BELLUS Health and certain of its subsidiaries. Interest will be capitalized on the 2009 Notes at the rate of 15% per year, compounded annually, and the notes and capitalized interest will mature 5 years and one day from the date of issuance. At maturity, capital and interest are payable in cash or common shares of BELLUS Health, at the option of the holder, at an initial price of CDN$0.20 per share (the Financing Conversion Price). The 2009 Notes include customary anti-dilution provisions in respect of issuances of securities or distributions to shareholders and, in the event BELLUS Health issues additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, "full ratchet" anti-dilution protection (which will have the effect of lowering the Financing Conversion Price to the new issue price of equity or equity-linked securities) will apply, subject to certain exceptions. Following the rights offering referred to above, the Financing Conversion Price has been adjusted to CDN$0.185. In addition, the 2009 Notes contain adjustment provisions in the event of a change of control, negative covenants, as well as a pre-emptive right in respect of future financings of BELLUS Health. The 2009 Notes issued to VSVI contains certain piggyback rights in favour of VSVI. The exercise of pre-emptive and piggyback rights will be subject to regulatory approval. Assuming that each of the 2009 Notes remain outstanding until maturity, is converted in full at the Financing Conversion Price and that all interest thereon is paid by the issuance of common shares at the Financing Conversion Price, the number of common shares issuable under the 2009 Notes is 229,566,525, representing a potential dilution factor of 208%, based on the number of common shares issued and outstanding as at December 31, 2009.

Under the term of the 2009 Notes, each of Vitus and VSVI has the right to nominate two members to the Board of Directors of BELLUS Health.

In connection with and as a condition to the 2009 Notes financing, BELLUS Health and all of the existing note holders agreed to amend the terms of the outstanding 2006 Notes and 2007 Notes (the Original Notes). Holders of $29,085,000 principal amount of 2006 Notes and $4,000,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into the preferred shares in the authorized capital of BELLUS Health and received 3,096 preferred shares per $1,000 aggregate principal amount of existing convertible notes, representing a conversion price equal to 200% of the Financing Conversion Price (resulting in a conversion price of CDN$0.40 per share) (the Preferred Share Conversion Price). A total of 102,431,160 preferred shares were issued to note holders who elected to receive preferred shares. Such preferred shares are convertible into common shares on a one-to-one basis at the option of the holder, subject to adjustment; entitle the holder to 6% cumulative dividends, payable in cash or common shares at the then market price at the option of the Company; and shall be automatically converted into common shares in April 2014. The amendment and immediate conversion of Original Notes into preferred shares triggered a gain on extinguishment of debt in the amount of $10,777,000 during the quarter ended June 30, 2009. Assuming that each of the preferred shares remains outstanding until maturity, is converted in full at the Preferred Share Conversion Price and that all dividends payable in respect of the preferred shares are paid by the issuance of common shares at an assumed market price of CDN$0.18, the number of common shares issuable on conversion of the preferred shares would be 152,950,719, representing a potential dilution factor of 138%, based on the number of common shares issued and outstanding as at December 31, 2009. The holders of Original Notes that chose not to convert their amended notes immediately into preferred shares retained Original Notes, amended as set out below.

Holders of $13,000,000 principal amount of 2006 Notes and the one remaining holder of 2007 Notes (aggregate principal amount of $500,000) agreed to amend the terms of their notes (Amended Notes), without immediate conversion into preferred shares. The amendments include providing for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of BELLUS Health at the then market price of the common shares; replacing the existing conversion rate adjustment period of October 2009 - November 2009 with a period from October 2012 - November 2012 for conversion of the Amended Notes at the then applicable market price of the common shares based on a twenty (20) day volume weighted average price at that time; and replacing the right of the holder to have BELLUS Health redeem the Original Notes in November 2011 with a right to have BELLUS Health first redeem the Amended Notes in January 2014 at the then face value of the Amended Notes. Amendments to the notes also include the removal of certain negative covenants. Amendment of this aggregate $13,500,000 principal amount of Original Notes triggered a gain on extinguishment of debt in the amount of $6,243,000 during the quarter ended June 30, 2009. Assuming that the Amended Notes are converted in full at an assumed market price of CDN$0.18 in 2012, when the price of such instruments gets adjusted based on the then market price of the common shares, and that all interest thereon is paid by way of issuance of common shares at an assumed market price of CDN$0.18, the number of common shares issuable under Amended Notes, would be 90,269,250, representing a potential dilution factor of 82%, based on the number of common shares issued and outstanding as at December 31, 2009.

BELLUS Health has agreed that the right to redeem the Amended Notes shall be exercisable 90 days prior to the maturity date of the 2009 Notes issued to the Investors. Any additional unsecured debt, other than operating facilities or debt that is pari passu or junior in ranking to the Amended Notes, shall not mature or be redeemable for cash prior to the date on which the redemption right of the Amended Notes comes into effect. In addition, BELLUS Health has agreed to certain restrictions on its ability to declare or pay dividends in cash while the 2009 Notes are outstanding.

The terms of the 2009 Notes and of the Amended Notes require the continued listing of the Company's shares on the TSX; failure to meet this requirement would be an event default which may result in the convertible notes becoming immediately due and payable. In the event of a delisting of the Company's shares on the TSX, the accrued dividends on the preferred shares would be payable in cash. As announced in the Company's March 31, 2009, press release, the TSX undertook a routine delisting review of BELLUS Health as a result of the Company's having invoked the financial difficulty exemption in connection with the 2009 Notes financing. On October 20, 2009, the Company received confirmation from the TSX that its Listing Committee had determined that the Company satisfies the TSX's continued listing requirements.

As a condition precedent to the 2009 financing, the landlord of the Company's premises in Laval, Quebec, agreed, effective April 1, 2009, and continuing through to and including April 7, 2011 (on which date BELLUS Health shall have the right to terminate the lease (the First Termination Option)), to defer BELLUS Health's base rent by CDN$167,000 per month minus any sublease revenue (the Deferred Rent). In the event BELLUS Health does not exercise its First Termination Option, the monthly deferral of the Deferred Rent will continue for an additional twelve-month period until March 31, 2012 (on which date BELLUS Health shall have the right to terminate the lease (the Second Termination Option)). The Deferred Rent shall bear interest at the rate of ten percent (10%) annually, calculated from the first date of the month when any such component of Deferred Rent becomes due and payable. Deferred Rent and the accrued interest are evidenced by promissory notes issued by BELLUS Health to its landlord on the first day of each month when such Deferred Rent becomes due. The notes are payable in cash or, at the option of BELLUS Health, through the issuance of common shares at the market price on the day that the notes become payable. Deferred Rent and all notes evidencing Deferred Rent shall be payable on April 7, 2011, in the event that the First Termination Option is exercised or, alternatively, on March 31, 2012. In the event that the lease is terminated under the First Termination Option or the Second Termination Option, BELLUS Health will pay the landlord consideration of CDN$6,000,000 or CDN$5,450,000, respectively, payable in common shares at the then market price of the common shares (the Termination Option Payment). The precise amount of rent and number of common shares issuable upon conversion of promissory notes to be issued to the landlord will depend, among other things, on the extent to which portions of the premises are sublet or assigned to other tenants during the relevant period. Assuming that the promissory notes issued to the landlord in respect of deferred rent and interest thereon remain outstanding until April 7, 2011, are paid by way of issuance of common shares at an assumed market price of CDN$0.18, and that the lease is terminated pursuant to the First Termination Option, the number of common shares issuable under the notes would be 57,009,888, representing a potential dilution factor of 52%, based on the number of common shares issued and outstanding as at December 31, 2009.

In May 2009, BELLUS Health issued 1,594,026 common shares in payment of interest on the outstanding Amended Notes. During the year ended December 31, 2009, the Company issued 4,600,000 common shares upon conversion of preferred shares.

During the year ended December 31, 2009, 825,000 options to purchase common shares were granted (2008 – 3,143,600 options), 652,617 options to purchase common shares were cancelled (2008 - 1,299,825 options) and 102,050 options to purchase common shares expired (2008 - nil). On January 11, 2010, 2,000,000 options were granted to the new President and Chief Executive Officer.

Investing activities

As at December 31, 2008, the Company held approximately $12,250,000 (of which $6,250,000 was denominated in Canadian dollars) in principal value of ABCP, including $5,719,000 of ABCP acquired as part of the Innodia acquisition. These investments were due to mature as early as August 2007, but, as a result of a disruption in the credit markets, particularly in the ABCP market, did not settle on maturity. On April 25, 2008, the restructuring plan announced by the Pan-Canadian Investors Committee (the Committee) in December 2007 was approved by the ABCP holders. On January 21, 2009, the Committee announced that the restructuring plan had been implemented. Pursuant to the terms of the restructuring plan, the Company received the following new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP: CDN$2,306,000 of MAV2 Class A-1 Notes, CDN$2,773,000 of MAV2 Class A-2 Notes, CDN$503,000 of MAV2 Class B Notes, CDN$173,000 of MAV2 Class C Notes, CDN$850,000 of MAV2 IA Tracking Notes, $5,000,000 of MAV3 IA Tracking Notes, as well as $977,000 and CDN$985,000 of MAV3 TA Tracking Notes. The legal maturity of the New ABCP Notes is July 15, 2056, but the actual repayment is expected to be in 2017. The New ABCP Notes issued following the restructuring plan are designated as “held for trading” financial assets. Previously, the ABCP was also classified in this category. During the year ended December 31, 2009, the Company received partial payments for capital, of $2,135,000, and for accrued interest, of $597,000. The Company has not recorded any interest income since the initial maturity of the ABCP it held; however, as the expected interest proceeds were considered in the determination of the fair value of the New ABCP Notes.

During the second quarter of 2008, the Company entered into a temporary credit facility with the chartered bank that sold the ABCP to the Company. On April 20, 2009, in connection with the restructuring of the ABCP market, the Company entered into new secured revolving credit facilities with that chartered bank, with a minimum 2-year term and with options to renew on an annual basis for up to a maximum total potential term of seven years. As of December 31, 2009, these new credit facilities have combined maximum aggregate amounts of approximately $10,372,000, of which $88,000 has yet to be drawn, bear interest at prime rate minus 1% per annum (the weighted average effective interest rate was 2.0% in 2009), and are secured by hypothecs having an aggregate principal amount of CDN$18,400,000 on New ABCP Notes issued to the Company, on the securities accounts in which they are held and on all proceeds of these notes. The amount of these new credit facilities decreases as capital payments are received on the New ABCP Notes. A portion of these facilities and all other obligations of the Company towards the chartered bank are secured by a hypothec on the universality of the Company’s assets in the amount of approximately CDN$2,000,000. The revolving credit facilities also include a put option feature in 2011 and 2012 which may limit the Company’s losses to between 25% and 55% of the New ABCP Notes, subject to certain conditions.

As at December 31, 2009, the Company estimated the fair value of the outstanding balance of New ABCP Notes at approximately $6,918,000, of which $308,000 is presented as part of Restricted Cash, as it is pledged to a bank as collateral for letter of credit issued in connection with a lease agreement. In connection with its fair value determinations, the Company recorded an increase in fair value of $269,000 for the year ended December 31, 2009 (2008 - $309,000). The exchange of ABCP for New ABCP Notes during the first quarter of 2009 resulted in a loss on settlement, which was presented as part of the decrease in fair value recorded during that period. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2009, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.28% (weighted average rate of 0.10%), depending on the series of New ABCP Notes. These future cash flows were discounted, according to the series, over a period of up to 8 years and using discount rates ranging from 4.3% to 8.3% (weighted average rate of 6.7%). The Company also took into account the put option feature described above in determining the change in fair value of the New ABCP Notes recognized in earnings for the years ended December 31, 2008 and 2009. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company's current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

Other

The reduction of the Company's research activities and associated workforce resulted in vacant space in the Company's premises. During the year ended December 31, 2009, the Company recorded a net credit for vacant space in the amount of $2,009,000. As part of the modifications to the lease agreement, the Company has options to terminate the lease in April 2011 or March 2012, as previously discussed. The Company has determined that these termination options constitute a material modification to the terms of the original lease. It has concluded that the lease should continue to be classified as operating and that the lease term for accounting purposes should now be assumed to end in April 2011. Accordingly, the deferred gain on sale of property and the deferred rent liability, recorded in 2005 at the time of the sale-leaseback transaction on the Company's premises, are amortized on a straight-line basis to April 2011, for the portion of the premises that the Company continues to occupy. The portion of the deferred gain on sale of property and deferred rent liability attributable to the premises no longer occupied by the Company was factored into the net credit for vacant space. The net credit for vacant space also includes a provision for lease consisting of the present value of future lease costs of the vacant portion of the premises, net of an estimate of the

sublease rentals that could reasonably be obtained, as well as an amount proportionate to the vacant space of the Lease Termination Option Payment. The provision is based on various assumptions, including the Company's estimated borrowing rate and obtainable sublease rates. These assumptions are influenced by market conditions and the availability of similar space nearby. If market conditions change for sublease rentals in the future, the Company will adjust the provision accordingly.

As at February 23, 2010, the Company had 112,103,026 common shares outstanding, 220,000 common shares issuable to Dr. Francesco Bellini upon the achievement of specified performance targets, 6,719,341 options granted under the stock option plan, 96,283,160 preferred shares outstanding which are convertible into common shares on a one for one basis, 13,589,602 warrants outstanding, as well as notes outstanding in the amount of $15,142,000 and CDN$21,115,000, which can either be settled in cash or convertible into common shares.

Contractual Obligations

As at December 31, 2009, BELLUS Health's future contractual obligations are principally for operating leases for facilities and office equipment, clinical trial outsourcing agreements, consulting fees for Picchio International, as well as payments in relation to the convertible notes and credit facilities. Future contractual obligations by year of maturity are presented below.

	Payments Due by Period *(in thousands of US dollars)*				
Contractual obligations	Total	Less than 1 year	2-3 years	4-5 years	More than 5 years
Operating leases (1)	11,324	993	10,331	Nil	Nil
Clinical trial agreements	1,608	1,552	56	Nil	Nil
Consulting fees	239	239	Nil	Nil	Nil
Credit facilities	11,721	Nil	Nil	Nil	11,721
Convertible notes (2)	33,675	Nil	Nil	33,675	Nil
Interest payments on convertible notes (2)	23,162	810	1,620	20,732	Nil
Dividends on preferred shares (3)	9,058	Nil	Nil	9,058	Nil

(1) Assumes exercise of the First Termination Option in April 2011. The Company will have the option to settle $9,788 with the issuance of common shares, including the redemption of promissory notes to landlord in April 2011.

(2) Assumes redemption of Amended Notes in January 2014 and redemption of 2009 Notes in April 2014. Refer to note 10 to the Consolidated Financial Statements for terms and conditions.

(3) Assume dividends on preferred shares paid in April 2014. The Company will have the option to settle the dividends with the issuance of common shares.

The Company has not engaged in commodity contract trading or off-balance sheet financing, other than in relation to operating leases and the sale-leaseback transaction, for which the contractual obligations under the operating leases are stated above. In addition, the Company is also responsible for operating costs and taxes under the operating leases.

The Company has letters of credit issued in connection with lease agreements in the amount of $975,000. An equivalent face value amount of New ABCP Notes are pledged under these letters of credit and are presented as restricted cash on the Consolidated Balance Sheet as at December 31, 2009. The balance of the New ABCP Notes is pledged under the credit facilities.

In December 2004, the Company entered into an agreement with its then Chief Executive Officer, Dr. Francesco Bellini, to issue to him up to 220,000 common shares upon the execution of the agreement and upon achievement of specified performance targets. In 2005, the Company recorded stock-based compensation in relation to 140,000 common shares to be issued to the Chief Executive Officer in connection with his execution and achievement of certain specified performance targets; these shares will be issued by the Company upon formal notification by Dr. Francesco Bellini.

The Company has entered into a number of other agreements, which involve future commitments, including agreements with Parteq Research and Development Innovations and the federal Ministry of Industry (Technology Partnerships Canada Program). Refer to note 13 of the Consolidated Financial Statements for the year ended December 31, 2009.

FINANCIAL RISK MANAGEMENT

This section provides disclosures relating to the nature and extent of the Company's exposure to risks arising from financial instruments, including credit risk, liquidity risk, foreign currency risk and interest rate risk, and how the Company manages those risks.

Credit Risk

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk of the Company as at December 31, 2009, is the carrying value of its financial assets, including the investment in New ABCP Notes. Credit risk relating to cash, cash equivalents, and restricted cash is managed by investing cash resources with major North American and European financial institutions. Cash equivalents are comprised of fixed income instruments with a high credit rating (not less than A-1) as rated by Standard and Poor's. The Company has investment policies that are geared towards the safety and preservation of principal, the Company's liquidity needs and yields that are appropriate. Refer to the Liquidity and Capital Resources section for a discussion of credit risk related to investment in New ABCP Notes.

The Company's exposure to credit risk related to accounts receivable arises from the possibility that a customer does not fulfill its obligations. This is minimized through a customer base predominantly comprised of well-established retailers and wholesalers, a program of credit evaluation of new customers and limits on the amount of credit extended as deemed necessary. The Company performs continuous evaluation of its accounts receivable and records an allowance for doubtful accounts, if necessary.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company requires continued access to capital markets to support its operations, as well as to achieve its strategic plans. Any impediments to the Company's ability to continue to meet the conditions contained in its credit facilities and convertible notes as well as the Company's ability to access capital markets, including the lack of financing capability or an adverse perception in capital markets of the Company's financial condition or prospects, could have a materially adverse effect on the Company. In addition, the Company's access to financing is influenced by the economic and credit market environment.

The Company manages liquidity risk through the management of its capital structure, as outlined in Note 19 to the Consolidated Financial Statements (Capital Disclosures). In addition, the Company manages liquidity risk by monitoring actual and projected cash flows as well as the impact of credit market conditions in the current environment. However, market conditions are beyond the control of the Company. The Board of Directors reviews and approves the Company's annual operating and capital budgets, as well as any material transactions out of the ordinary course of business.

The contractual maturities of financial liabilities at December 31, 2009, are presented in Note 20(c) to the Consolidated Financial Statements.

As discussed earlier, as at December 31, 2009, the Company's committed cash obligations and expected level of expenses exceed the committed sources of funds and the Company's cash and cash equivalents on hand. The Company is actively pursuing additional financing. The Company is currently involved in ongoing discussions with several parties to secure partnership agreement, collaboration agreement, licensing agreement and/or sales with respect to its businesses, product or product candidates. While the discussions could lead to the signing of binding agreements in the future, no such transactions have been concluded as of February 23, 2010. There can be no assurance whatsoever that any such transaction will be put in place. The ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through collaborative research contracts or product licensing agreements, and ultimately, from obtaining regulatory approval in various jurisdictions, to market and sell its product candidates and achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company's control. As a result, there is significant doubt as to whether the Company will have the ability to continue as a going concern and thereby realize its assets and discharge its liabilities in the normal course of business.

Foreign Currency Risk

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Prior to December 31, 2009, the US dollar was the Company's functional and reporting currency. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than US dollars. The Company's exposure relates primarily to changes in the US dollar versus the Canadian dollar exchange rate. For the Company's foreign currency transactions, fluctuations in the respective exchange rates relative to the US dollar will create volatility in the Company's cash flows and the reported amounts for revenue and expenses in its consolidated statement of operations. Additional variability arises from the translation of monetary assets and liabilities denominated in currencies other than the US dollar at the rates of exchange at each balance sheet date, the impact of which is reported as a foreign exchange gain or loss in the statement of operations. The Company's objective in managing its foreign currency risk is to minimize its net exposures to foreign currency cash flows, by transacting with third parties in the Company's functional currency to the maximum extent possible and practical and holding cash and cash equivalents and incurring borrowings in its functional currency. The Company does not use forward foreign exchange contracts. Note 20(d) to the Consolidated Financial Statements provides indication of the Company's significant foreign exchange currency exposures as at December 31, 2009. Refer to the Critical Accounting Policies and Estimates for details on the Company's decision to convert to the CDN dollar effective January 1, 2010.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates. The Company's financial instruments exposed to interest rate risk are cash and cash equivalents, restricted cash, investments in New ABCP Notes, credit facilities and convertible notes. The risk that the Company will realize a loss as a result of the decline in the fair value of its cash equivalents is limited because these investments, although available for sale, have short-term maturities. The capacity of the Company to reinvest the short-term

amounts with equivalent returns will be impacted by variations in short-term fixed interest rates available in the market.

The Company has had no interest rate hedging activities during the current year.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its reports filed with securities regulatory authorities is recorded, processed, summarized and reported within prescribed time periods and is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Company's Chief Executive Officer and its Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in the reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified by applicable securities legislation. The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of certain events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. They are assisted in this responsibility by the Company's disclosure committee, which is composed of members of senior management. Based on an evaluation of the Company's disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2009.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management's Annual Report on Internal Control Over Financial Reporting

Internal control over financial reporting (ICFR) is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Management, including the Company's Chief Executive Officer and its Chief Financial Officer, is responsible for establishing and maintaining adequate ICFR. The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of certain events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Management assessed the effectiveness of the Company's ICFR as of December 31, 2009 based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concluded that the Company's ICFR were effective as of December 31, 2009. This MD&A does not include an attestation report of the Company's auditors regarding ICFR.

Changes in Internal Controls Over Financial Reporting

There have been no changes in the Company's ICFR during the year ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect its ICFR.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements in accordance with GAAP requires management to adopt accounting policies and to make certain estimates and assumptions that the Company believes are reasonable based upon the information available at the time these decisions are made. These accounting policies, estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues, expenses and cash flows during the reporting periods. By their nature, these judgments are subject to an inherent degree of uncertainty and are based upon historical experience, trends in the industry and information available from outside sources. On an ongoing basis, management reviews its estimates and actual results could differ from estimates. Refer to notes 6 and 10 to the consolidated financial statements for estimates used in the valuation of the investment in New ABCP Notes and the convertible notes, respectively. The Company's significant accounting policies are described in Notes 2 and 3 to the Consolidated Financial Statements. Management considers that the following accounting policies and estimates are the more important in assisting an understanding and evaluating the Company's consolidated financial statements.

Going Concern Assumption: The consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. These financial statements do not include any adjustments to the carrying value and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to find a buyer with respect to its business, to receive significant funds on signing collaborative research and development contracts, distribution agreements or by out licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes, would be reduced to liquidation value.

Revenue recognition: The Company recognizes revenue in accordance with the CICA handbook Section 3400 *Revenue* and Emerging Issues Committee (EIC) Abstract 141 *Revenue Recognition*. This guidance states that revenue recognition should take place when realized or realizable and earned. Revenue recognition occurs upon meeting all of the following criteria: persuasive evidence of an arrangement exists; the product has been delivered; there are no future performance obligations; the selling price is fixed and determinable; and collection is reasonably assured.

The Company recognizes revenues when the title and risk of ownership is transferred to the customer, and the above criteria are satisfied, which is generally at the time of delivery of products to customers.

Net sales are presented net of allowances for product returns and cooperative promotional incentives. These allowances are recorded at the time sales are recognized. The Company establishes allowances for product returns and cooperative promotional incentives based on numerous qualitative and quantitative factors, which include: specific terms of arrangements with customers; historical product returns and cooperative promotional incentives; historical data from the industry; direct communication with customers; anticipated pricing strategy changes by the Company and/or its competitors; the effect of regulatory changes and the estimated remaining shelf life of products.

Research and development costs consist of direct and indirect expenditures, including a reasonable allocation of overhead expenses, associated with the Company's various research and development programs. Research and development costs are expensed as incurred. Overhead expenses comprise general and administrative support provided to the research and development programs and involve costs associated with support activities such as facility operating costs, office services, information technology and human resources. The Company accrues clinical trial expenses based on work performed, which relies on estimates of total costs incurred based on completion of patient studies and other events. The Company follows this method since reasonable dependable estimates of the costs applicable to various stages of a research agreement or clinical trial can be made. Accrued clinical costs are subject to revisions as trials progress to completion. Research tax credits recorded are management's belief for which there is reasonable assurance of collection. Research tax credits claimed for current and prior years are subject to current government review which could result in adjustment to earnings.

New ABCP Notes: The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2009, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. The Company also took into account the put option feature described above in determining the change in fair value of the New ABCP Notes recognized in earnings for the years ended December 31, 2008 and 2009. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company's current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

Stock-based compensation is recorded using the fair value based method for stock options issued to employees and non-employees subsequent to July 1, 2002. Under this method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period. The Company uses the Black-Scholes options pricing model to calculate stock option values, which requires certain assumptions, including the future stock price volatility and expected time to exercise. Changes to any of these assumptions, or the use of a different option pricing model, could produce different fair values for stock-based compensation, which could have a material impact on the Company's earnings.

Change in functional and reporting currency

As a result of significant changes in the economic facts and circumstances which occurred in 2009, such as changes in the research and development programs and the general business model, delisting from the NASDAQ and deregistration of its shares from the SEC, and obtaining new financing from the 2009 Notes and the rights offering in Canadian dollars, the Company has determine that the Canadian dollar will more accurately reflect the current and future state of the Company. As a result of the above mentioned changes, a significant portion of the Company's expenses, assets, liabilities and financing are denominated in Canadian dollars. Therefore, effective January 1, 2010, the Company adopted the Canadian dollar as its functional and reporting currency. Beginning in 2010, assets and liabilities as of December 31, 2009, will be translated in Canadian dollars using the exchange rate in effect on that date, and equity transactions will be translated at historical rates. Any exchange differences resulting from the translation will be included in other comprehensive income presented in shareholders deficiency.

CHANGE IN ACCOUNTING POLICIES

New accounting pronouncements adopted in 2009

On January 1, 2009, the Company adopted the following new accounting standards issued by the CICA:

Goodwill and intangible assets:

Section 3064, *Goodwill and Intangible Assets*, replaced Section 3062, *Goodwill and Other Intangible Assets,* and Section 3450, *Research and Development Costs.* The standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition, as well as clarifies the application of the concept of matching revenues and expenses, whether these assets are separately acquired or internally developed. As a result of this standard, direct costs incurred to secure patents related to internally-generated assets are no longer capitalized by the Company. The Company applied this standard on a retrospective basis.

The impact of adopting this standard was to write off the amount of patents previously capitalized of $6,156,000; to increase the opening deficit as at January 1, 2008, by $5,652,000, which is the amount relating to periods prior to this date; to decrease the net loss by $128,000 for the year ended December 31, 2008; and to decrease accumulated other comprehensive income as at January 1, 2008 by $504,000 due to foreign exchange adjustments.

Credit risk and the fair value of financial assets and financial liabilities:

On January 20, 2009, the Emerging Issues Committee (EIC) of the Canadian Accounting Standards Board (AcSB) issued EIC Abstract 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities*, which establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC 173 should be applied retrospectively without restatement of prior years and is applicable to the Company for its first quarter of fiscal 2009. The application of this recommendation did not have a significant impact on the Company's consolidated financial statements.

Financial Instruments – Disclosures:

In June 2009, the AcSB issued amendments to CICA Handbook Section 3862, *Financial Instruments – Disclosures* in order to align with International Financial Reporting Standard IFRS 7, *Financial Instruments: Disclosures*. This Section has been amended to include additional disclosure requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure. The amendments establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The amendments apply to annual financial statements relating to fiscal years ended after September 30, 2009 and are applicable to the Company as at December 31, 2009. The amended Section relates to disclosure only and did not impact the financial results of the Company.

Financial assets and liabilities fairly valued on a recurring basis:

	December 31, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	$13,393,000	$13,393,000	$ –	$ –
Investment in New ABCP Notes and restricted cash	6,918,000	–	–	6,918,000
Other restricted cash	365,000	365,000	–	–
Liabilities:				
Derivative-related liability	356,000	–	–	356,000

Recent accounting pronouncements to be adopted

The following accounting standards were recently issued by the CICA:

International Financial Reporting Standards (IFRS)

In February 2008, AcSB confirmed that Canadian GAAP, as used by publicly accountable enterprises, will be fully converged into International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Therefore, the Company will be required to report under IFRS for its 2011 interim and annual financial statements.

During the year, the Company began planning the transition from current Canadian GAAP to IFRS by establishing a project plan and a project team. The project team is led by senior finance executives that provide overall project governance, management and support. The project team will report quarterly to the Company's Audit Committee. The project plan consists of three phases: the initial assessment, detailed assessment and design, and implementation. The Company has completed the initial assessment phase, which included the completion of a high level review of the major differences between current Canadian GAAP and IFRS, and an initial evaluation of IFRS 1 transition exemptions. The initial assessment included discussions with the Company's external auditors. The Company is now engaged in the detailed assessment and design phase. The detailed assessment and design phase involves completing a comprehensive analysis of the impact of the IFRS differences identified in the initial assessment phase. The design of solutions to resolve these IFRS differences are progressing according to plan and set out below are the main areas where changes to accounting policies are expected at this time:

- Presentation of Financial Statements (IAS 1)
- Financial instruments (IAS 32 and 39)
- Share Based Payments (IFRS 2)
- Leases (IAS 17)

The Company is in the implementation phase during which it is implementing the identified changes to business processes, financial systems, accounting policies, disclosure controls and internal controls over financial reporting. The Company continues to assess the financial reporting impacts of converting to IFRS and, at this time, the impact on future financial position and results of operations is not reasonably determinable or estimable.

RISKS AND UNCERTAINTIES

Since its inception in 1993, BELLUS Health has incurred significant operating losses. The Company's pharmaceutical product candidates are in development and none have yet been approved for commercialization by regulatory authorities in any jurisdiction. The Company's business entails significant risks, including the costs and time involved in obtaining the required regulatory approvals, the adequacy of patent protection, the uncertainties involved in clinical testing, the availability of capital to continue development and commercialization of the products, and competition from pharmaceutical, biotechnology and nutraceutical companies.

Significant funding is required for ongoing research and development, clinical trials, marketing, commercial manufacturing of products and the establishment of sales and marketing teams necessary for the launch and ongoing sales of new products. In addition, major financial resources are necessary until such time as the products are commercialized and sold successfully, and sales are sufficient to generate profits. The Company intends to raise additional financing, as required, through research, partnership and licensing agreements, the exercise of stock options and warrants, and through equity and/or debt financing. However, there can be no assurance that these financing efforts will be successful or that the Company will continue to be able to meet its ongoing cash requirements. It is possible that financing will not be available or, if available, may not be on favourable terms.

The availability of financing will be affected by the results of scientific research and clinical development, the Company's ability to obtain regulatory approvals, the market acceptance of the Company's products, the state of the capital markets generally (with particular reference to pharmaceutical, biotechnology, nutraceutical and medical companies), the status of strategic alliance agreements, and other relevant commercial considerations.

Product research and development involves a high degree of risk, and returns to investors are dependent upon successful development and commercialization of the Company's products. A setback in any of the Company's clinical trials may cause a drop in the Company's stock price. Difficulties encountered in enrolling patients in the Company's clinical trials could delay or adversely affect the trials. There can be no assurance that development of any product will be successfully completed or that regulatory approval of any of the Company's products under development will be obtained. Furthermore, there can be no assurance that existing products or new products developed by competitors will not be more effective, or more effectively marketed and sold, than any that may be developed by the Company. There can be no assurance that the Company's future potential products will gain market acceptance among physicians, patients, healthcare payers, the medical community and consumers. In addition, given the very high costs of development of pharmaceutical products, the Company anticipates having to partner with larger pharmaceutical companies to bring pharmaceutical products to market. The terms of such partnership arrangements along with the related financial obligations cannot be determined at this time and the timing of completion of the approval of such products will likely not be within the Company's control.

Because of the length of time and expense associated with bringing new products through development, obtaining regulatory approval and bringing products to market, the Company places considerable importance on obtaining and maintaining patent protection and safeguarding trade secret protection for significant discoveries. There can be no assurance that any pending patent application filed by the Company will mature into an issued patent. Furthermore, there can be no assurance that existing or pending patent claims will offer protection against competition, or will not be designed around or infringed upon by others. Commercial success will also depend in part on the Company not infringing patents or proprietary rights of others. Patent litigation is costly and time consuming and may subject the Company to liabilities.

The Company is currently dependent on third parties for a variety of functions and may enter into future collaborations for the development, manufacture and commercialization of products, including the commercialization of VIVIMIND™. There is no assurance that the arrangements with these third parties will provide benefits the Company expects. There can also be no assurance that the Company will be successful in manufacturing, marketing and distributing products, or that the Company will be able to make adequate arrangements with third parties for such purposes. There can be no assurance that the Company will generate significant revenue or achieve profitability.

A detailed discussion on the Company's risks and uncertainties can be found in the Company's public filings including the Annual Information Form and prospectuses available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

Certain statements included in this Management's Discussion and Analysis may constitute "forward-looking statements" within the meaning of Canadian securities legislation and regulations, and are subject to important risks, uncertainties and assumptions. This forward-looking information includes among others, information with respect to the Company's objectives and the strategies to achieve these objectives, as well as information with respect to the Company's beliefs, plans, expectations, anticipations, estimates and intentions. Forward-looking statements generally can be identified by the use of conditional or forward-looking terminology such as "may", "will", "expect", "intend", "estimate", "anticipate", "plan", "foresee", "believe" or "continue" or the negatives of these terms or variations of them or similar terminology. Refer to the Company's filings with the Canadian securities regulatory authorities, as well as the "Risks and Uncertainties" section of this Management's Discussion and Analysis, for a discussion of the various factors that may affect the Company's future results. Such risks include but are not limited to: the ability to obtain financing immediately in current markets, the impact of general economic conditions, general conditions in the pharmaceutical and/or nutraceutical industry, changes in the regulatory environment in the jurisdictions in which the BELLUS Health group does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, and that actual results may vary once the final and quality-controlled verification of data and analyses has been completed. The results or events predicted in forward-looking information may differ materially from actual results or events. The Company believes that expectations represented by forward-looking statements are reasonable, yet there can be no assurance that such expectations will prove to be correct. Unless otherwise stated, the forward-looking statements contained in this report are made as of the date of this report, and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable legislation or regulation. The forward-looking statements contained in this report are expressly qualified by this cautionary statement.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements have been prepared by management and approved by the Board of Directors of the Company. The consolidated financial statements were prepared in accordance with accounting principles generally accepted in Canada and, where appropriate, reflect management's best estimates and judgments. Where alternative accounting methods exist, management has chosen those methods deemed most appropriate in the circumstances. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality, and for the consistency of financial data included in the text of the Management's Discussion and Analysis with the data contained in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls over financial reporting as described in the Management's Discussion and Analysis.

The Company's Audit Committee is appointed by the Board of Directors annually and is comprised exclusively of outside, independent directors. The Audit Committee meets with management as well as with the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The Audit Committee considers, for review by the Board of Directors and approval by the shareholders, the engagement or reappointment of the independent auditors. The external auditors, KPMG LLP, have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been independently audited by KPMG LLP, Chartered Accountants, on behalf of the shareholders, in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Company.

(Signed) Roberto Bellini,
President and
Chief Executive Officer

(Signed) François Desjardins, C.A.
Vice President, Finance

Laval, Quebec, Canada
February 23, 2010

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AUDITORS' REPORT

To the Shareholders of BELLUS Health Inc.

We have audited the consolidated balance sheets of BELLUS Health Inc. (the "Company") as at December 31, 2009 and 2008, the consolidated statements of operations and comprehensive loss, shareholders' deficiency and cash flows for the years then ended and the consolidated statements of operations and comprehensive loss and cash flows for the period from inception (June 17, 1993) to December 31, 2009. 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended and for the period from inception (June 17, 1993) to December 31, 2009, in accordance with Canadian generally accepted accounting principles.

KPMG LLP*

Chartered Accountants

Montréal, Canada

February 5, 2010

*CA Auditor permit no 10892

BELLUS HEALTH INC.

Consolidated Balance Sheets

December 31, 2009 and 2008
(in thousands of US dollars, unless otherwise noted)

	December 31, 2009 (CDN$ - note 1 (b))	December 31, 2009 (US$)	December 31, 2008 (US$) (Recast - note 3 (a))
Assets			
Current assets:			
Cash and cash equivalents (note 17 (a))	$ 14,017	$ 13,393	$ 10,595
Accounts receivable and other	379	362	593
Research tax credits receivable	3,618	3,457	1,780
Inventories	152	145	180
Prepaid expenses	799	764	1,114
	18,965	18,121	14,262
Investment in New ABCP Notes (note 6)	6,918	6,610	8,392
Restricted cash (note 6)	704	673	596
Long-term prepaid expenses	150	143	42
Equipment (note 7)	2,593	2,479	3,124
	$ 29,330	$ 28,026	$ 26,416
Liabilities and Shareholders' Deficiency			
Current liabilities:			
Accounts payable	$ 740	$ 707	$ 2,423
Accrued liabilities	3,927	3,752	5,495
Deferred gain on sale of property (note 7)	6,001	5,734	1,339
	10,668	10,193	9,257
Credit facilities (note 6)	10,763	10,284	9,736
Deferred gain on sale of property (note 7)	1,351	1,291	14,563
Long-term liabilities (note 9)	8,407	8,033	1,448
Notes (note 10)	17,348	16,577	37,464
	48,537	46,378	72,468
Shareholders' deficiency:			
Share capital (note 11)	322,807	308,434	274,554
Equity portion of convertible notes (note 10)	11,744	11,221	9,841
Additional paid-in capital	23,494	22,448	18,402
Warrants (note 11 (h))	17,643	16,857	16,857
	375,688	358,960	319,654
Deficit	(401,483)	(383,607)	(372,001)
Accumulated other comprehensive income	6,588	6,295	6,295
	(394,895)	(377,312)	(365,706)
	(19,207)	(18,352)	(46,052)
Basis of presentation (note 1 (a))			
Commitments and contingencies (note 13)			
Subsequent events (note 21)			
	$ 29,330	$ 28,026	$ 26,416

See accompanying notes to consolidated financial statements.

On behalf of the Board of Directors by:

(Signed) Hélène Fortin
Director

(Signed) Joseph Rus
Director

BELLUS HEALTH INC.

Consolidated Statements of Operations and Comprehensive Loss

Years ended December 31, 2009 and 2008 and period from inception (June 17, 1993) to December 31, 2009 (in thousands of US dollars, except per share data, unless otherwise noted)

	Year ended December 31, 2009 (CDN$ - note 1 (b))	Year ended December 31, 2009 (US$)	Year ended December 31, 2008 (US$) (Recast - note 3 (a))	Cumulative since inception of operations (US$)
Revenues:				
Gross sales	$ 336	$ 321	$ 423	$ 744
Discounts, returns and cooperative promotional incentives	(457)	(437)	(113)	(550)
Net sales	(121)	(116)	310	194
Collaboration agreement (note 5)	–	–	205	6,325
Reimbursable costs	–	–	69	2,200
Research contracts	–	–	–	6,038
License fees	–	–	–	733
	(121)	(116)	584	15,490
Expenses:				
Research and development	11,737	11,213	25,027	260,862
Research tax credits and grants	(1,226)	(1,171)	(1,430)	(23,854)
Other research and development charges	–	–	–	1,127
	10,511	10,042	23,597	238,135
General and administrative	6,557	6,265	12,605	102,794
Marketing and selling	3,882	3,709	6,661	10,370
Arbitral award	–	–	–	1,835
Reimbursable costs	–	–	69	2,200
Stock-based compensation	2,408	2,301	2,309	19,514
Special charges	–	–	–	1,288
Depreciation of equipment	725	693	870	9,209
Net credit for vacant space (note 8 (b) (ii))	(2,103)	(2,009)	–	(2,009)
	21,980	21,001	46,111	383,336
Loss before undernoted items	(22,101)	(21,117)	(45,527)	(367,846)
Interest income	107	102	907	12,598
Interest and bank charges	(339)	(324)	(271)	(2,138)
Accretion expense (note 10 and 11 (d))	(5,440)	(5,198)	(4,937)	(25,990)
Change in fair value of embedded derivatives (note 10)	43	41	86	(743)
Gain on extinguishment of debt (notes 10 (b) and 11 (d))	17,813	17,020	–	17,020
Change in fair value of New ABCP Notes (note 6)	282	269	309	(606)
Gain on technology transfer	–	–	–	2,306
Foreign exchange (loss) gain	(455)	(434)	287	719
Other income	1,480	1,414	1,051	6,184
Share of loss in a company subject to significant influence	–	–	–	(5,346)
Non-controlling interest	–	–	–	1,678
	13,491	12,890	(2,568)	5,682
Net loss before income taxes	(8,610)	(8,227)	(48,095)	(362,164)
Income taxes:				
Quebec credit for losses	–	–	–	464
Net loss and comprehensive loss	$ (8,610)	$ (8,227)	$ (48,095)	$ (361,700)
Net loss per share (note 16):				
Basic	$ (0.06)	$ (0.06)	$ (0.97)	
Diluted	(0.17)	(0.17)	(0.97)	

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Shareholders' Deficiency

Years ended December 31, 2009 and 2008
(in thousands of US dollars)

	Share capital	Equity portion of convertible notes	Additional paid-in capital	Warrants	Deficit	Accumulated other comprehensive income	Total
	(note 11 (b))						
Balance December 31, 2008, before recast	$ 274,554	$ 9,841	$ 18,402	$ 16,857	$ (366,477)	$ 6,799	$ (40,024)
Adjustment to reflect change in accounting policy for goodwill and intangible assets (note 3 (a))	–	–	–	–	(5,524)	(504)	(6,028)
Balance December 31, 2008, recast	274,554	9,841	18,402	16,857	(372,001)	6,295	(46,052)
Stock-based compensation (note 12)	–	–	1,247	–	–	–	1,247
Equity portion of 2009 convertibles Notes (note 10 (a))	–	11,194	–	–	(545)	–	10,649
Extinguishment of 2006 and 2007 Notes (notes 10 (b) and 11 (d))	–	(9,841)	2,799	–	(2,205)	–	(9,247)
Issuance of 2006 and 2007 Amended Notes (note 10 (b))	–	27	–	–	–	–	27
Issuance of preferred shares (note 11 (d))	24,303	–	–	–	(240)	–	24,063
Issued on payment of interest on convertible Notes (note 10 (b))	810	–	–	–	–	–	810
Conversion of preferred shares into common shares (note 11 (d))	92	–	–	–	–	–	92
Deferred tax liability on preferred shares (note 11 (d))	(316)	–	–	–	–	–	(316)
Issued on exercise of Rights offering (note 11 (c))	8,991	–	–	–	(389)	–	8,602
Net loss	–	–	–	–	(8,227)	–	(8,227)
Balance, December 31, 2009	$ 308,434	$ 11,221	$ 22,448	$ 16,857	$ (383,607)	$ 6,295	$ (18,352)

BELLUS HEALTH INC.

Consolidated Statements of Shareholders' Deficiency, Continued

Years ended December 31, 2009 and 2008
(in thousands of US dollars)

	Share capital	Equity portion of convertible notes	Additional paid-in capital	Warrants	Deficit	Accumulated other comprehensive income	Total
	(note 11 (b))						
Balance December 31, 2007, before recast	$ 273,269	$ 9,841	$ 15,397	$ 16,857	$ (318,254)	$ 6,799	$ 3,909
Adjustment to reflect change in accounting policy for goodwill and intangible assets (note 3 (a))	–	–	–	–	(5,652)	(504)	(6,156)
Balance December 31, 2007, recast	273,269	9,841	15,397	16,857	(323,906)	6,295	(2,247)
Exercise of stock options: For cash	7	–	–	–	–	–	7
Acquisition of Innodia Inc. (note 4)	1,278	–	680	–	–	–	1,958
Stock-based compensation (note 12)	–	–	2,325	–	–	–	2,325
Net loss	–	–	–	–	(48,095)	–	(48,095)
Balance, December 31, 2008	$ 274,554	$ 9,841	$ 18,402	$ 16,857	$ (372,001)	$ 6,295	$ (46 052)

See accompanying notes to consolidated financial statements.

BELLUS HEALTH INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2009 and 2008 and period from inception (June 17, 1993) to December 31, 2009
(in thousands of US dollars, unless otherwise noted)

	Year ended December 31, 2009	Year ended December 31, 2009	Year ended December 31, 2008	Cumulative since inception of operations
	(CDN$ - note 1 (b))	(US$)	(US$) (Recast - note 3 (a))	(US$)
Cash flows from operating activities:				
Net loss	$ (8,610)	$ (8,227)	$ (48,095)	$ (361,700)
Adjustments for:				
Depreciation	725	693	870	9,209
Unrealized foreign exchange loss	1,356	1,296	249	2,844
Stock-based compensation	2,408	2,301	2,309	19,514
Share of loss in a company subject to significant influence	–	–	–	5,346
Non-controlling interest	–	–	–	(1,678)
Accretion expense (notes 8, 10 and 11 (d))	4,973	4,752	4,937	25,990
Change in fair value of embedded derivatives	(43)	(41)	(86)	743
Gain on extinguishment of debt	(17,813)	(17,020)	–	(17,020)
Net credit for vacant space	(2,103)	(2,009)	–	(2,009)
Change in fair value of New ABCP Notes	(282)	(269)	(309)	606
Amortization of deferred rent liabilities	1,105	1,056	400	1,456
Amortization of gain on sale-leaseback	(4,261)	(4,071)	(1,339)	(8,108)
Deferral of lease payments by issuance of promissory notes	1,458	1,393	–	1,393
Amortization of deferred financing fees	–	–	–	47
Write-off of leasehold improvements and equipment	–	–	–	914
Provision for lease exit obligations	–	–	–	374
Gain on technology transfer	–	–	–	(2,306)
Shares issued for services	–	–	–	30
Settlement of deferred shares units	(74)	(71)	–	(71)
Changes in operating assets and liabilities:				
Accounts receivable	242	231	272	(23)
Research tax credits receivable	(1,755)	(1,677)	1,161	(1,769)
Prepaid expenses	260	249	560	(100)
Inventories	37	35	(180)	(145)
Deferred revenue	–	–	(6,205)	(1,012)
Accounts payable and accrued liabilities	(4,442)	(4,244)	(9,751)	(6,023)
	(26,819)	(25,623)	(55,207)	(333,498)

BELLUS HEALTH INC.

Consolidated Statements of Cash Flows, Continued

Years ended December 31, 2009 and 2008 and period from inception (June 17, 1993) to December 31, 2009
(in thousands of US dollars, unless otherwise noted)

	Year ended December 31, 2009 (CDN$ - note 1 (b))	Year ended December 31, 2009 (US$)	Year ended December 31, 2008 (US$) (Recast - note 3 (a))	Cumulative since inception of operations (US$)
Cash flows from financing activities:				
Credit facilities	$ 35	$ 33	$ 7,694	$ 7,727
Proceeds from 2006 and 2007 Notes	–	–	–	121,930
Financing fees	–	–	–	(7,345)
2009 Notes, net of issue costs	18,224	17,413	–	17,413
Issue costs on 2006 and 2007 notes refinancing	(321)	(307)	–	(307)
Proceeds from sale-leaseback	–	–	–	27,807
Repayment of obligations under capital lease	–	–	–	(2,214)
Proceeds from long-term debt	–	–	–	8,052
Repayment of long-term debt	–	–	–	(8,052)
Proceeds from issue of share capital	–	–	7	203,623
Share issue costs	–	–	–	(12,758)
Common shares issued on exercise of Rights offering	9,003	8,602	–	8,602
	26,941	25,741	7,701	364,478
Cash flows from investing activities:				
Restricted cash	(205)	(196)	(145)	(6,860)
Additions to equipment	(71)	(68)	(193)	(18,888)
Additions to long-term investment	–	–	–	(1,855)
Proceeds from New ABCP Notes	2,859	2,732	–	2,732
Proceeds from marketable securities	–	–	47,709	6,568
Innodia acquisition costs, net of cash acquired	–	–	(233)	(233)
	2,583	2,468	47,138	(18,536)
Net increase (decrease) in cash and cash equivalents	2,705	2,586	(368)	12,444
Cash and cash equivalents, beginning of period	11,089	10,595	10,963	–
Effect of foreign exchange on cash and cash equivalents	223	212	–	949
Cash and cash equivalents, end of period	$ 14,017	$ 13,393	$ 10,595	$ 13,393

Supplemental disclosures to cash flow statements (note 17)

See accompanying notes to consolidated financial statements.

1. Organization, business activities and basis of presentation:

BELLUS Health Inc. ("BELLUS Health" or the "Company") is a global health company focused on the development and commercialization of products to provide innovative health solutions to address critical unmet needs.

Since inception, the business activities of the Company have been devoted principally to the development of the Company's core technology platform, amyloid inhibitors, which focus on chemical compounds that could have the potential to inhibit the formation, deposition and toxicity of amyloid fibrils which are implicated or believed to be the underlying causes of certain diseases. The diseases currently targeted by the Company include Amyloid A (AA) amyloidosis, Alzheimer's disease, as well as Type II diabetes and certain features of metabolic syndrome. The status of the Company's pharmaceutical principal product candidates is as follows:

Disease indication	Product candidate	Stage of development
AA amyloidosis	eprodisate (KIACTA™)	Phase III clinical trial
Type II diabetes and certain features of metabolic syndrome	NC-503 (eprodisate)	Phase II clinical trial
Alzheimer's disease	prodrug of tramiprosate	Preclinical development
Type II diabetes and certain features of metabolic syndrome	prodrug of NC-503	Research

BELLUS Health is considered to be in the development stage, with clinical trials for two of its programs. Since inception, substantially all of the Company's research and development expenditures, capital expenditures, including costs incurred to secure patents, and all revenues from milestone payments, collaboration agreements and research contracts relate to the Company's core technology platform.

1. Organization, business activities and basis of presentation (continued):

To date, the Company has financed its operations primarily through public offerings of common shares, private placements, issuance of convertible notes, as well as a sale-leaseback transaction, research tax credits, collaboration and research contracts, interest and other income. The future profitability of the Company is dependent upon such factors as the success of the clinical trials, the approval by regulatory authorities of products developed by the Company, the ability of the Company to successfully market, sell and distribute products, including its natural health products, and the ability of the Company to obtain the necessary financing to complete its projects. In January 2009, the Company delisted its shares from NASDAQ. Additionally, in May 2009, the Company deregistered its securities from the US Securities and Exchange Commission (SEC). The Company's shares trade on the Toronto Stock Exchange (TSX).

In September 2008, the Company launched its first product, VIVIMIND^{TM}, in Canada and globally on the Internet. VIVIMIND^{TM} is a natural health brand designed to protect memory function.

(a) Basis of presentation:

The Company has incurred significant operating losses and negative cash flows from operations since inception and has an accumulated deficit of $383,607 as at December 31, 2009. As at that date, the Company had cash and cash equivalents in the amount of $13,393.

As at December 31, 2009, the Company’s committed cash obligations and expected level of expenses for the upcoming twelve months exceed the committed sources of funds, and the Company’s cash and cash equivalents on hand. The ability of the Company to continue as a going concern is dependent upon raising additional financing through borrowings, share issuances, receiving funds through collaborative research contracts, distribution agreements or product licensing agreements, sales with respect to its businesses, and ultimately, from obtaining regulatory approval in various jurisdictions to market and sell its product candidates and achieving future profitable operations. The outcome of these matters is dependent on a number of factors outside of the Company’s control. These factors raise significant doubt about the Company's ability to continue as a going concern beyond 2010.

Management continues to actively pursue additional sources of funds. The Company is currently involved in ongoing discussions with several parties to secure partnership agreements, collaboration arrangements, licensing arrangements and/or sales with respect to its businesses, product or product candidates. While the discussions could lead to the signing of binding agreements in the future, there can be no assurance whatsoever that any such transaction will be put in place. As a result, there is material uncertainty as to whether the Company will have the ability to continue as a going concern beyond 2010, and thereby realize its assets and discharge its liabilities in the normal course of business.

1. Organization, business activities and basis of presentation (continued):

(a) Basis of presentation (continued):

The consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business. These financial statements do not include any adjustments to the carrying values and classification of assets and liabilities and reported revenues and expenses that may be necessary should the Company not be successful in its efforts to obtain additional financing, to find a buyer with respect to its businesses, to receive significant funds on signing collaborative research and development contracts, distribution agreements or by out-licensing its products or making significant product sales. Such adjustments may include, but would not be limited to: all debt would be presented as current debt, accretion on convertible notes would be accelerated, and all assets, including the investment in New ABCP Notes, would be reduced to liquidation value.

(b) Translation of convenience:

The Company's functional currency is the US dollar. The Company also presents the consolidated financial statements as at and for the period ended December 31, 2009, in Canadian dollars, using the convenience translation method, whereby all US dollar amounts are converted into Canadian dollars at the noon exchange rate quoted by the Bank of Canada as at December 31, 2009, which was 1.0466 Canadian dollars per US dollar. The supplementary information in Canadian dollars is presented only for the convenience of some readers and thus has limited usefulness. This translation should not be viewed as a representation that such US dollar amounts actually represent such Canadian dollar amounts or could be or would have been converted into Canadian dollars at the rate indicated.

1. Organization, business activities and basis of presentation (continued):

(c) Change in functional and reporting currency:

As a result of significant changes in the economic facts and circumstances which occurred in 2009, such as changes in the research and development programs and the general business model, delisting from the NASDAQ and deregistration of its shares from the SEC, and obtaining new financing from the 2009 Notes and rights offering in Canadian dollars (note 10 (a) and 11 (c)), the Company has determine that the Canadian dollar will more accurately reflect the current and future state of the Company. As a result of the above mentioned changes, a significant portion of the Company's expenses, assets, liabilities and financing are denominated in Canadian dollars. Therefore, effective January 1, 2010, the Company adopted the Canadian dollar as its functional and reporting currency. Beginning January 1, 2010, assets and liabilities as of December 31, 2009, will be translated in Canadian dollars using the exchange rate in effect on that date, and equity transactions will be translated at historical rates. Any exchange differences resulting from the translation will be included in accumulated other comprehensive income presented in shareholders' deficiency.

2. Significant accounting policies:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

(a) Principles of consolidation:

The consolidated financial statements include the accounts of BELLUS Health and its subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

(b) Cash and cash equivalents:

The Company considers all investments with maturities of three months or less at inception, that are highly liquid and readily convertible into cash, to be cash equivalents.

(c) Inventories:

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories, production or conversion cost and other costs incurred in bringing them to their existing location and condition. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

2. Significant accounting policies (continued):

(d) Equipment:

Equipment is stated at cost. Depreciation is provided at the following annual rates:

Asset	Basis	Rate/period
Research equipment	Declining balance	20%
Office equipment	Declining balance	20%
Computer hardware	Declining balance	30%
Computer software	Straight-line	1-2 years

(e) Impairment of long-lived assets:

Long-lived assets, including equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the difference between the carrying amount and the fair value. Quoted market values are used whenever available to estimate fair value. When quoted market values are unavailable, the fair value of the long-lived asset is generally based on estimates of discounted expected net cash flows.

(f) Revenue recognition:

Revenue from collaboration agreements that includes multiple elements is considered to be a revenue arrangement with multiple deliverables. Under this type of arrangement, the identification of separate units of accounting is required and revenue is allocated among the separate units based on their relative fair values. Payments received under a collaboration agreement may include upfront payments, regulatory and sales-based milestone payments for specific achievements, as well as distribution fees. Upfront and regulatory milestone payments, which require the Company's ongoing involvement, are deferred and amortized into income on a straight-line basis over the estimated period of service. Sales-based milestone payments, for which the Company has no future involvement or obligations to perform related to that specified element of the arrangement, are recognized into income upon the achievement of the specified milestones. Distribution fees are recognized when the service has been performed, the amount is determinable and collection is reasonably assured.

2. Significant accounting policies (continued):

(f) Revenue recognition (continued):

License fees are recorded when conditions and events under the license agreement have been met or occurred, and collectability is reasonably assured.

Reimbursable costs incurred in connection with the Company's collaboration agreement with Centocor, Inc. are presented on a gross basis and therefore included in total revenues and expenses.

Revenues from the sale of products are recognized when persuasive evidence of an arrangement exists, the product has been delivered, there are no future performance obligations, the selling price is fixed and determinable, and collection is reasonably assured. Sales allowances for products returns and cooperative promotional incentives are recorded at the time sales are recognized as a reduction of revenue.

Interest income is recognized using the effective interest method.

(g) Research and development:

Research expenditures are expensed as incurred and include a reasonable allocation of overhead expenses. Development expenditures are deferred when they meet the criteria for capitalization in accordance with Canadian GAAP, and the future benefits could be regarded as being reasonably certain. As at December 31, 2009 and 2008, no development costs were deferred.

(h) Government assistance:

Government assistance, consisting of grants and research tax credits, is recorded as a reduction of the related expense or cost of the asset acquired. Grants are recorded when there is reasonable assurance that the Company has complied with the terms and conditions of the approved grant program. Research tax credits are recorded when there is reasonable assurance of their recovery. Research tax credits recorded are those in management’s belief for which there is a reasonable assurance of collection. Research tax credits claimed for the current and prior years are subject to current government review which could result in adjustments to earnings.

(i) Foreign exchange:

Monetary assets and liabilities denominated in foreign currencies are translated at year-end exchange rates. Non-monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the transaction date. Income and expenses denominated in foreign currencies are translated at exchange rates in effect at the transaction date. Translation gains and losses are included in income.

2. Significant accounting policies (continued):

(j) Income taxes:

Income taxes are provided for using the liability method. Under this method, differences between the financial reporting bases and the income tax bases of the Company's assets and liabilities are recorded using the substantively enacted tax rates anticipated to be in effect when the tax differences are expected to reverse. A valuation allowance is recorded against any future tax asset if it is not more likely than not that the asset will be realized.

(k) Costs associated with lease exit activities:

Costs associated with lease obligations for leased premises that are no longer being used by the Company are recognized and measured at fair value as of the cease-use date. The fair value of the liability at the cease-use date is determined based on the remaining lease rentals, reduced by estimated sublease rentals that could reasonably be obtained for the property, measured using the credit-adjusted risk-free rate.

(l) Earnings per share:

Basic earnings per share are determined using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed in a manner consistent with basic earnings per share, except that the weighted average number of shares outstanding is increased to include additional shares from the assumed exercise of options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding options and warrants were exercised, and that the proceeds from such exercises were used to acquire common shares at the average market price during the reporting period. The dilutive effect of the convertible notes is reflected in diluted earnings per share by application of the "if-converted" method, if dilutive. Under the if-converted method, convertible notes are assumed to have been converted at the beginning of the period (or at time of issuance, if later) and the resulting common shares are included in the denomination for purposes of calculating diluted earnings per share.

(m) Stock-based compensation:

The Company follows the fair value based method to account for options granted to employees and non-employees, whereby compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period.

2. Significant accounting policies (continued):

(n) Financial instruments:

The Company has designated its financial instruments as follows:

Cash and cash equivalents and restricted cash are classified as "Financial Assets Available for Sale". These financial assets are marked-to-market at each reporting date with all unrealized gains and losses recognized in comprehensive income. Other-than-temporary impairment losses on these financial assets are recognized in income.

Investments in New ABCP Notes are classified as "Held for Trading". These financial assets are remeasured at each reporting date at fair value with all gains and losses recognized in income.

Accounts receivable and other are classified as "Loans and Receivables". Accounts payable, accrued liabilities and notes are classified as "Other Financial Liabilities". After their initial fair value measurement, these financial instruments are measured at amortized cost using the effective interest rate method.

Derivative instruments are recorded as either assets or liabilities measured at their fair value each period through earnings unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. Embedded derivatives are required to be separated from the host contract and accounted for as a derivative financial instrument if the embedded derivative and host contract are not closely related, and the combined contract is not held for trading or designated at fair value.

Transactions costs are capitalized to the cost of financial assets and liabilities when they are not classified as held for trading. Thus, financing costs relating to notes are classified as a reduction in notes and are being amortized using the effective rate method over the life of the related debt.

2. Significant accounting policies (continued):

(o) Use of estimates:

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant areas requiring the use of management estimates include estimating the useful lives and recoverability of equipment, estimating accruals for clinical trial expenses, estimating the timing of regulatory approvals for revenue recognition purposes, estimating the provision for sales returns and allowances, estimating the fair value of investment in New ABCP Notes (defined in note 6), allocating the proceeds received from issuance of convertible notes between debt and equity components, estimating the expected life of the convertible notes as well as assessing the acceptance by the government agencies of investment tax credit claims made by the Company and the recoverability of research tax credits. The reported amounts and note disclosures reflect management's best estimate of the most probable set of economic conditions and planned course of actions. Actual results could differ from these estimates.

3. Changes in accounting policies:

(a) Accounting changes in 2009:

On January 1, 2009, the Company adopted the following new accounting standards issued by the CICA:

Goodwill and intangible assets:

Section 3064, *Goodwill and Intangible Assets*, replaces Section 3062, *Goodwill and Other Intangible Assets,* and Section 3450, *Research and Development Costs.* The standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition, as well as clarifies the application of the concept of matching revenues and expenses, whether these assets are separately acquired or internally developed. As a result of this standard, direct costs incurred to secure patents related to internally-generated assets are no longer capitalized by the Company. The Company applied this standard on a retrospective basis.

3. Changes in accounting policies (continued):

(a) Accounting changes in 2009 (continued):

Goodwill and intangible assets (continued):

The impact of adopting this standard was to write off the amount of patents previously capitalized of $6,156; to increase the opening deficit as at January 1, 2008, by $5,652, which is the amount relating to periods prior to this date; to decrease the net loss by $128 for the year ended December 31, 2008; and to decrease accumulated other comprehensive income as at January 1, 2008 by $504 due to foreign exchange adjustments.

Credit risk and the fair value of financial assets and financial liabilities:

On January 20, 2009, the Emerging Issues Committee (EIC) of the Canadian Accounting Standards Board (AcSB) issued EIC Abstract 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities*, which establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC 173 should be applied retrospectively without restatement of prior years and is applicable to the Company for its first quarter of fiscal 2009. The application of this recommendation did not have a significant impact on the Company's consolidated financial statements.

Financial Instruments – Disclosures:

In June 2009, the AcSB issued amendments to CICA Handbook Section 3862, *Financial Instruments – Disclosures* in order to align with International Financial Reporting Standard IFRS 7, *Financial Instruments: Disclosures*. This Section has been amended to include additional disclosure requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure. The amendments establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The amendments apply to annual financial statements relating to fiscal years ended after September 30, 2009 and are applicable to the Company as at December 31, 2009. The amended Section relates to disclosure only and did not impact the financial results of the Company.

3. Changes in accounting policies (continued):

(a) Accounting changes in 2009 (continued):

Financial Instruments – Disclosures (continued):

Financial assets and liabilities fairly valued on a recurring basis, as at December 31, 2009:

	December 31, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 13,393	$ 13,393	$ –	$ –
Investment in New ABCP Notes and restricted cash	6,918	–	–	6,918
Other restricted cash	365	365	–	–
Liabilities:				
Derivative-related liability	(356)	–	–	(356)

For the year ended December 31, 2009, the reconciliation of the beginning and ending balance of assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) was as follows:

	Investment in New ABCP Notes and restricted cash	Derivative-related liability
Beginning balance, January 1, 2009	$ 8,988	$ –
Proceeds	(2,732)	–
Issuance of 2009 Notes	–	(363)
Foreign exchange	393	(34)
Total gains included in earnings (reported as change in fair value)	269	41
Ending balance, December 31, 2009	$ 6,918	$ (356)

3. Changes in accounting policies (continued):

(a) Accounting changes in 2009 (continued):

Financial Instruments – Disclosures (continued):

	Investment in New ABCP Notes and Restricted cash	Derivative-related liability
Amount of total gains for the period included in earnings attributable to the change in unrealized gain related to assets and liabilities still held at reporting date	$ 269	$ 41

(b) Future accounting changes:

International Financial Reporting Standards:

In February 2008, the AcSB confirmed that Canadian GAAP, as used by publicly accountable enterprises, will be fully converged into International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Therefore, the Company will be required to report under IFRS for its 2011 interim and annual financial statements.

4. Acquisition of Innodia Inc.:

On July 17, 2008, the Company acquired 100% of the remaining outstanding capital stock that it did not already own of Innodia Inc. (Innodia), a private, development stage company engaged in developing compounds for the treatment of diabetes, obesity and related metabolic conditions and diseases. Prior to the acquisition, the Company indirectly held 23% of Innodia's capital stock. The Company acquired all of the operations of Innodia, including the intellectual property assets related to its diabetes and obesity projects. As a result of the acquisition, the Company also regained exclusive rights to its own diabetes platform and all related compounds, some of which had previously been licensed to Innodia. The purchase price was settled by the issuance from treasury of 1,185,797 common shares of the Company. In July 2009, the additional consideration that was conditionally payable on the first anniversary of the closing of the transaction, based on the value at that time of the Innodia investment in asset-backed commercial paper, was determined to be nil.

4. Acquisition of Innodia Inc. (continued):

The transaction has been accounted for as an acquisition of assets, and the results of Innodia have been consolidated with the accounts of the Company since the date of the acquisition.

The following purchase price allocation is based on management's best estimate of the relative fair values of the identifiable assets acquired and liabilities assumed.

Purchase price allocation:		
Cash	$	54
Accounts receivable and other		90
Research tax credits receivable		1,134
Investment in ABCP		4,242
Total assets acquired		5,520
Bank indebtedness		(2,042)
Accounts payable and accrued liabilities		(1,778)
Long-term liabilities		(135)
Total liabilities assumed		(3,955)
Net assets acquired	$	1,565
Purchase price:		
1,185,797 common shares issued	$	1,278
Transaction costs		287
	$	1,565

Refer to note 6 for investment in New ABCP Notes.

Concurrent with the acquisition, Innodia Holdings, a variable interest entity of which the Company is the primary beneficiary, repurchased for nominal consideration and for cancellation its outstanding shares (the non-controlling interest) held by companies affiliated with one of the Company's shareholders. As a result of this transaction, the Company now holds all of the outstanding shares of Innodia Holdings. As the transaction was between related parties, the settlement of the non-controlling interest was credited to additional paid-in capital.

Identifiable intangible assets and property and equipment were reduced to nil, and the investment in ABCP was reduced by $684 because the fair value of the net assets acquired exceeded their purchase price. The fair value of the investment in ABCP was subsequently increased by $684, through earnings, to reflect its fair value as at December 31, 2008.

5. Collaboration agreement:

On April 15, 2008, the Company announced that it had regained full ownership rights and control of eprodisate (KIACTA™) from Centocor, Inc. (Centocor). During the second quarter of 2008, the refundable portion ($6,000) of the upfront payment received from Centocor in 2005, recorded as deferred revenue, was refunded to Centocor. Since this obligation was secured by ABCP, the Company entered into a credit facility with the chartered bank that sold the ABCP to the Company to finance the repayment (note 6).

The agreement with Centocor ended in 2008. The Company recognized $205 of revenue for the year ended December 31, 2008, under the agreement, representing the amortization of the non-refundable upfront payment for the period from signing the agreement in December 2004, over the remaining estimated service period.

6. Investment in New ABCP Notes:

As at December 31, 2008, the Company held approximately $12,250 (of which $6,250 was denominated in Canadian dollars) in principal value of ABCP, including $5,719 of ABCP acquired as part of the Innodia acquisition. These investments were due to mature as early as August 2007, but, as a result of a disruption in the credit markets, particularly in the ABCP market, did not settle on maturity. On April 25, 2008, the restructuring plan announced by the Pan-Canadian Investors Committee (the Committee) in December 2007 was approved by the ABCP holders. On January 21, 2009, the Committee announced that the restructuring plan had been implemented. Pursuant to the terms of the restructuring plan, the Company received the following new floating rate interest-bearing notes (New ABCP Notes) in exchange for its ABCP: CDN$2,306 of MAV2 Class A-1 Notes, CDN$2,773 of MAV2 Class A-2 Notes, CDN$503 of MAV2 Class B Notes, CDN$173 of MAV2 Class C Notes, CDN$850 of MAV2 IA Tracking Notes, $5,000 of MAV3 IA Tracking Notes, as well as $977 and CDN$985 of MAV3 TA Tracking Notes. The legal maturity of the New ABCP Notes is July 15, 2056, but the actual repayment date is expected to be in 2017. The New ABCP Notes issued following the restructuring plan are designated as “held for trading” financial assets. Previously, the ABCP was also classified in this category. During the year ended December 31, 2009, the Company received partial payments for capital of $2,135, and for accrued interest of $597. The Company has not recorded any interest income since the initial maturity of the ABCP it held, as the expected interest proceeds were considered in the determination of the fair value of the New ABCP Notes.

6. Investment in New ABCP Notes (continued):

During the second quarter of 2008, the Company entered into a temporary credit facility with the chartered bank that sold the ABCP to the Company. On April 20, 2009, in connection with the restructuring of the ABCP market, the Company entered into new secured revolving credit facilities with that chartered bank, with a minimum 2-year term and with options to renew on an annual basis for up to a maximum total potential term of seven years. As of December 31, 2009, these new credit facilities have combined maximum aggregate amounts of approximately $10,372, of which $88 has yet to be drawn, bear interest at prime rate minus 1% per annum (weighted average effective interest rate was 2.0% in 2009), and are secured by hypothecs having an aggregate principal amount of CDN$18,400 on New ABCP Notes issued to the Company, on the securities accounts in which they are held and on all proceeds of these notes. The amount of these new credit facilities decreases as capital payments are received on the New ABCP Notes. A portion of these facilities and all other obligations of the Company towards the chartered bank are secured by a hypothec on the universality of the Company's assets in the amount of approximately CDN$2,000. The revolving credit facilities also include a put option feature in 2011 and 2012 which may limit the Company's losses to between 25% and 55% of the New ABCP Notes, subject to certain conditions.

6. Investment in New ABCP Notes (continued):

As at December 31, 2009, the Company estimated the fair value of the outstanding balance of New ABCP Notes at approximately $6,918, of which $308 is presented as part of Restricted Cash, as it is pledged to a bank as collateral for letter of credit issued in connection with a lease agreement. In connection with its fair value determinations, the Company recorded an increase in fair value of $269 for the year ended December 31, 2009 (2008 - $309). The exchange of ABCP for New ABCP Notes during the first quarter of 2009 resulted in a loss on settlement, which was presented as part of the decrease in fair value recorded during that period. The Company is aware of a limited number of trades in the restructured notes that occurred prior to December 31, 2009, but does not consider them to be of a sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. The Company estimates the fair value of the New ABCP Notes using a probability weighted discounted cash flow approach, based on its best estimates of the period over which the assets will generate cash flows; the coupon interest rate; the discount rate to apply to the net cash flows anticipated to be received commensurate with the return on comparably rated notes in accordance with the risk factors of the different investments; and other qualitative factors. The Company estimates that the New ABCP Notes will generate interest returns ranging from nil to 0.28% (weighted average rate of 0.10%), depending on the series of New ABCP Notes. These future cash flows were discounted, according to the series, over a period of up to 8 years and using discount rates ranging from 4.3% to 8.3% (weighted average rate of 6.7%). The Company also took into account the put option feature described above in determining the change in fair value of the New ABCP Notes recognized in earnings for the years ended December 31, 2008 and 2009. Estimates of the fair value of the New ABCP Notes and related put option are not supported by observable market prices or rates, and therefore are subject to uncertainty, including, but not limited to, the estimated amounts to be recovered, the yield of the financial instruments and the timing of future cash flows, and the market for these types of instruments. The resolution of these uncertainties could be such that the ultimate fair value of these investments may vary significantly from the Company's current estimate. Changes in the near-term could require significant changes in the recognized amount of these assets. As the Company records the New ABCP Notes at current fair value each period, such adjustments directly impact earnings.

7. Equipment:

			2009
	Cost	Accumulated depreciation	Net book value
Research equipment	$ 7,589	$ 5,706	$ 1,883
Computer hardware and software	3,336	2,999	337
Office equipment	912	653	259
	$ 11,837	$ 9,358	$ 2,479

			2008
	Cost	Accumulated depreciation	Net book value
Research equipment	$ 7,589	$ 5,234	$ 2,355
Computer hardware and software	3,278	2,846	432
Office equipment	958	621	337
	$ 11,825	$ 8,701	$ 3,124

On November 17, 2005, the Company entered into a sale and leaseback transaction for its facilities for a sale price of $26,411. The transaction generated a net gain of $20,085. The net gain is deferred and is being amortized over the modified term of the lease as a reduction of rent expense (refer to note 8 (b) (i)). Rent expense is calculated on a straight-line basis over the original term of the lease.

8. Restructuring charges:

(a) Workforce reduction:

During the first quarter of 2009, the Company reduced its research activities and associated workforce to focus on its key projects. The associated costs, totaling approximately $722, were expensed and paid in the first half of 2009. These costs are presented on the following lines in the statement of operations: Research and development ($361), General and administrative ($315) and Marketing and selling ($46). In conjunction with this workforce reduction and the changes to the Company's Board of Directors that occurred during the second quarter of 2009, the terms of certain stock options were modified to prolong the life of the options which would have otherwise ended on termination for certain employees and Directors. The modifications did not have a significant impact on the financial statements of the Company.

(b) Lease of premises:

As a result of the restructuring of its activities, the Company now occupies approximately two thirds of the premises it initially occupied under a lease that was to expire in 2020.

(i) Amendment to lease:

As a condition precedent to the 2009 Notes financing (refer to Note 10 (a)), the landlord of the Company's premises in Laval, Quebec, agreed, effective April 1, 2009, and continuing through to and including April 7, 2011 (on which date BELLUS Health shall have the right to terminate the lease (the First Termination Option)), to defer BELLUS Health's base rent by CDN$167 per month minus any sublease revenue (the Deferred Rent). In the event BELLUS Health does not exercise its First Termination Option, the monthly deferral of the Deferred Rent will continue for an additional twelve-month period until March 31, 2012 (on which date BELLUS Health shall have a second right to terminate the lease (the Second Termination Option)). The Deferred Rent bears interest at the rate of ten percent (10%) annually, calculated from the first date of the month when any such component of Deferred Rent becomes due and payable. Deferred Rent and the accrued interest thereon are evidenced by promissory notes issued by BELLUS Health to its landlord on the first day of each month when such Deferred Rent becomes due. The promissory notes are payable in cash or, at the option of BELLUS Health, through the issuance of common shares at the market price on the day on which the notes become payable. Deferred Rent and all notes evidencing Deferred Rent shall be payable on April 7, 2011, in the event that the First Termination Option is exercised or, alternatively, on March 31, 2012. The promissory notes are financial liabilities classified as Notes in the financial statements; therefore, after initial recognition at fair value, they are accounted for at amortized cost.

8. Restructuring charges (continued):

(b) Lease of premises (continued):

(i) Amendment to lease (continued):

In the event that the lease is terminated under the First Termination Option or the Second Termination Option, BELLUS Health will pay the landlord consideration of CDN$6,000 or CDN$5,450, respectively, payable in common shares at the then market price of the common shares (the Termination Option Payment). The Company has determined that these termination options constitute a material modification to the terms of the original lease. It has concluded that the lease should continue to be classified as operating and that the lease term for accounting purposes should now be assumed to end in April 2011. Accordingly, the deferred gain on sale of property and the deferred rent liability, recorded in 2005 at the time of the sale leaseback transaction on the Company's premises, are amortized on a straight-line basis to April 2011 for the portion of the premises that the Company continues to occupy. A portion of the deferred gain on sale of property and deferred rent liability has been attributed to the premises no longer occupied by the Company and factored into the net credit for vacant space described in (ii) below.

(ii) Vacant space:

The reduction of the Company's research activities and associated workforce as described above resulted in vacant space in the Company's premises. For the year ended December 31, 2009, the Company recorded a net credit for vacant space in the amount of $2,009, resulting from the vacancy of a portion of its leased premises.

This amount includes:

- A provision for lease consisting of future lease costs of the vacant portion of the premises, net of an estimate of the sublease rentals that could reasonably be obtained, as well as an amount proportionate to the vacant space of the Lease Termination Option Payment ($2,089).

Less:

- An amount proportionate to the vacant space of the deferred gain on sale of property ($3,782), and
- An amount proportionate to the vacant space of the deferred rent liability ($316).

8. Restructuring charges (continued):

(b) Lease of premises (continued):

(ii) Vacant space (continued):

The net credit for vacant space is determined on the basis of the net present value of foregoing items over the remaining lease period. The net credit accretion on the foregoing items amounted to $446 for the year ended December 31, 2009, and is presented in General and Administrative expenses in the Statement of Operations. The estimate is based on various assumptions, including the Company's estimated borrowing rate of 41.02 % and obtainable sublease rates. These assumptions are influenced by market conditions and the availability of similar space in the area. If market conditions change for sublease rentals in the future, the Company will adjust the provision accordingly.

Changes in the provision for the year ended December 31, 2009 are as follows:

		Provision for lease
Initial provision	$	1,902
Adjustment to provision		187
Payments		(857)
Accretion expense		662
Foreign exchange loss		419
Provision as at December 31, 2009	$	2,313
Current portion		176
Long-term portion	$	2,137

9. Long-term liabilities:

Long-term liabilities consist of:

	2009	2008
Lease exit obligation (note 8)	$ 2,137	$ –
Deferred rent liability	2,120	1,311
Deferred share unit plan (note 11 (g))	1,082	19
Advance from a government agency	122	118
Debt component of preferred shares (note 11 (d))	2,149	–
Deferred tax liability on preferred shares (note 11 (d))	423	–
	$ 8,033	$ 1,448

10. Notes:

Notes consist of the following:

	Face value	Book value	
	December 31, 2009	December 31, 2009	December 31, 2008
15% Senior convertible notes due in 2014 (2009 Notes) (a)	$ 20,175	$ 8,936	$ –
6% Senior convertible notes due in 2026 (2006 Notes) (b)	13,000	5,595	35,437
6% Senior convertible notes due in 2027 (2007 Notes) (b)	500	227	3,148
Derivative-related liability (asset) (a) and (b)	–	356	(1,121)
Deferred Rent promissory notes (note 8 (b) (i))	1,463	1,463	–
	$ 35,138	$ 16,577	$ 37,464

10. Notes (continued):

(a) On April 16, 2009, the Company announced the completion of the first tranche of a CDN$20,500 convertible notes (the 2009 Notes) financing with Vitus Investments III Private Limited (Vitus), a corporation whose shares are beneficially owned by Mr. Carlo Bellini, and Victoria Square Ventures Inc. (VSVI), a subsidiary of Power Corporation of Canada (together with Vitus, the Investors). On that date, BELLUS Health received gross proceeds of CDN$10,000 for the issuance of 2009 Notes (CDN$5,000 from each Vitus and VSVI). On June 3, 2009, BELLUS Health received a second tranche of CDN$10,500 (CDN$5,000 from Vitus and CDN$5,500 from VSVI) and issued additional 2009 Notes in consideration for the second tranche principal amount received. The aggregate amount of the 2009 Notes issued to the Investors was increased by CDN$615 to cover a setup fee in connection with the financing.

The 2009 Notes are secured, subject to certain permitted encumbrances, by a first charge on all of the assets of BELLUS Health and certain of its subsidiaries. Interest is capitalized on the 2009 Notes at the rate of 15% per year, compounded annually, and the notes and capitalized interest mature April 2014. At maturity, capital and interest are payable in cash or common shares of BELLUS Health, at the option of the holder, at an initial price of CDN$0.20 (the Financing Conversion Price). The 2009 Notes include customary anti-dilution provisions in respect of issuances of securities or distributions to shareholders and, in the event BELLUS Health issues additional equity or equity-linked securities at a price per common share that is less than the Financing Conversion Price then in effect, “full ratchet” anti-dilution protection (which will have the effect of lowering the Financing Conversion Price to the new issue price of equity or equity-linked securities) applies, subject to certain exceptions. Following the rights offering in September 2009, the Financing Conversion Price has been adjusted to CDN$0.185. In addition, the 2009 Notes contain adjustment provisions in the event of a change of control, negative covenants, as well as a pre-emptive right in respect of future financings of BELLUS Health. The 2009 Notes issued to VSVI contain certain piggyback rights in favour of VSVI. The exercise of pre-emptive and piggyback rights is subject to regulatory approval.

10. Notes (continued):

(a) (continued):

The 2009 Notes are accounted for as a compound financial instrument and are presented in their component parts of debt and equity. The Company allocated the proceeds from the 2009 Notes between its liability and equity components using the residual value method. The 2009 Notes proceeds were allocated as follows: CDN$7,447 (US$6,401) to debt, net of issue costs of CDN$382 (US$332), CDN$12,869 (US$11,194) to equity portion of the convertible notes and CDN$417 (US$363) to derivative-related liability. Issue costs of CDN$627 (US$545) in relation to equity instruments were charged to the deficit. The debt component is measured at the issue date as the present value of the cash payments of interest and principal due under the terms at a rate which approximates the estimated interest rate of a similar non-convertible financial instrument with comparable terms and risk. The fair value of the embedded derivatives was determined using the Binomial model. The difference between the debt components and the face value of the 2009 Notes has been allocated to equity. The models used in the valuation of the components of the convertible notes contain certain subjective assumptions, changes to which would have cause significant variation in the estimated fair value of the debt and equity components of the convertible notes.

The Company accretes the carrying value of the 2009 Notes to their face value through a charge to earnings over their expected lives, which is 60 months. The unrecognized accretion expense on the 2009 Notes amounted to $31,649 at December 31, 2009 and will be recognized over the remaining expected life of 51 months. Any adjustment will be recognized as income or expense in net earnings. The effective interest rate of the 2009 Notes is 35.79%.

Changes in the 2009 Notes and derivative-related liability for the year ended December 31, 2009 were as follows:

		2009 Notes		Derivative-related liability
Balance as at December 31, 2008	$	–	$	–
Issuance of 2009 Notes		6,401		363
Accretion expense		1,756		–
Change in fair value		–		(41)
Foreign exchange loss		779		34
Balance as at December 31, 2009	$	8,936	$	356

10. Notes (continued):

(b) In connection with and as a condition to the 2009 Notes financing, BELLUS Health and all of the existing noteholders agreed, in order to reduce cash interest payments, to amend the terms of the outstanding 2006 Notes and 2007 Notes (the Original Notes). Holders of $29,085 principal amount of 2006 Notes and $4,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into preferred shares in the authorized capital of BELLUS Health. Refer to Note 11 (d).

Holders of $13,000 principal amount of the 2006 Notes and one remaining holder of 2007 Notes (aggregate principal amount of $500) agreed to amend the terms of their notes (the Amended Notes), without immediate conversion into preferred shares. The amendments include providing for a 6% annual interest rate, payable semi-annually in cash or common shares at the option of BELLUS Health at the then market price of the common shares, and replacing the conversion rate adjustment period and redemption dates. Amendments to the notes also include the removal of certain negative covenants.

The following are terms of the 2006 Amended Notes. Any principal not converted is to be paid upon maturity in 2026. The 2006 Amended Notes are convertible into common shares based on a modified conversion rate of 62.3974 shares per $1 principal amount of the notes ($16.03 per share, see note 11 (c)). The 2006 Amended notes are convertible, at the option of the holder, under the following conditions:

(i) if the closing sale price of the Company's common shares for each of 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter exceed 120% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter;

(ii) during the five consecutive business days immediately after any five consecutive trading day period in which the average trading price per $1 principal amount of 2006 Amended Notes was equal to or less than 97% of the average conversion value of the 2006 Amended Notes;

(iii) if the Company makes certain distributions on its common shares or engages in certain transactions;

(iv) on or after October 15, 2012 and on or before November 15, 2012;

(v) holder have the right to have BELLUS Health redeem the Amended Notes on each of January 17, 2014, November 15, 2014, November 15, 2016 and November 15, 2021, at a purchase price in cash equal to 100% of the then face value of the 2006 Amended Notes, plus accrued and unpaid interests.

10. Notes (continued):

(b) (continued):

On October 15, 2012, the conversion rate of the 2006 Amended Notes will be adjusted to an amount equal to a fraction whose numerator is $1 and whose denominator is the average of the closing sale prices of the common shares during the 20 trading days immediately preceding, and including, the third business day immediately preceding October 15, 2012. However, no such adjustment will be made if the adjustment will reduce the conversion rate. On and after November 15, 2012, the conversion rate will be readjusted back to the conversion rate that was in effect prior to October 15, 2012.

The following are terms of the 2007 Amended Notes. Any principal not converted is to be paid upon maturity in 2027. The 2007 Amended Notes are convertible at the option of the holder into fully paid and nonassessable common shares at anytime on or after April 16, 2010, based on a conversion price of $0.975 per share. The conversion price may be fixed, subject to shareholder's approval, for the period from, and including, October 15, 2012, to, and including, November 15, 2012. At the option of the holder, the Notes potentially may be repurchased by BELLUS Health on January 17, 2014 and November 15, 2014, at a purchase price in cash equal to 100% of the then face value of the 2007 Amended Notes, plus accrued and unpaid interests.

In accordance with Canadian GAAP, the amendment of the Original Notes into the Amended Notes was accounted for as an extinguishment of the Original Notes. The difference between the fair value of the Amended Notes over the book value of the Original Notes and related embedded derivatives resulted in a gain on extinguishment of debt in the amount of $6,243 in the statement of operations, net of a loss of $125 on settlement of the 2007 Original Notes embedded derivative asset. The fair value of Amended Notes was determined by using a probability weighted average of cash flows under the terms of the Amended Notes using a rate of 41.02%. Concurrently, the equity portion of the Original Notes in the amount of $2,799 was reclassified to additional paid-in capital. The Amended Notes were accounted for as compound financial instruments with both a debt and an equity component. The debt component in the amount of $5,041, net of issue costs of $51, was measured at the amendment date as the present value of the interest and principal payments, while the residual amount of $27 was allocated to the equity component.

10. Notes (continued):

(b) (continued):

The Company accretes the carrying value of the 2006 and 2007 Amended Notes to their face values through a charge to earnings over their expected lives, which are 48 and 44 months, respectively. As at December 31, 2009, the unrecognized accretion expense amounted to $9,974 for the 2006 Amended Notes and $362 for the 2007 Amended Notes and will be recognized over the remaining expected lives of 39 and 35 months, respectively. The effective interest rate is 35.61% for the 2006 Amended Notes and 36.34% for the 2007 Amended Notes.

Changes in the 2006 Notes, 2007 Notes and derivative-related asset for the year ended December 31, 2009 were as follows:

	2006 Notes	2007 Notes	Derivative-related asset
Original Notes:			
Balance as at December 31, 2007	$ 33,618	$ 2,825	$ (1,022)
Accretion expense	4,344	593	–
Interest paid/payable	(2,525)	(270)	–
Change in fair value	–	–	(99)
Balance as at December 31, 2008	35,437	3,148	(1,121)
Accretion expense	1,312	186	–
Interest paid/payable	(736)	(80)	–
Extinguishment	(36,013)	(3,254)	1,121
	–	–	–
Amended Notes:			
Issuance of Amended Notes	4,846	195	–
Accretion Expense	1,312	46	–
Interest paid/payable	(563)	(14)	–
Balance as at December 31, 2009	$ 5,595	$ 227	$ –

During the year ended December 31, 2009, accrued and unpaid interest due on the 2006 and 2007 Original and Amended Notes of $780 and $30, respectively, were paid via the issuance of 3,431,794 common shares, at the then market price of the shares.

The terms of the 2009 Notes and of the Amended Notes require the continued listing of the Company's shares on the TSX; failure to meet this requirement would be an event of default which may result in the convertible notes becoming immediately due and payable.

11. Share capital:

(a) The authorized share capital of the Company consists of:

- an unlimited number of voting common shares
- an unlimited number of non-voting preferred shares, issuable in one or more series

(b) Issued and outstanding shares are as follows:

	Common shares		Preferred shares		Total
	Number	Dollars	Number	Dollars	Dollars
Balance December 31, 2007	48,846,595	$ 273,269	–	$ –	$ 273,269
Exercise of stock options For cash	11,500	7	–	–	7
Acquisition of Innodia Inc. (note 4)	1,185,797	1,278	–	–	1,278
Balance December 31, 2008	50,043,892	274,554	–	–	274,554
Issued on payment of interest on Convertible Notes (Note 10 (b))	3,431,794	810	–	–	810
Issued on Conversion of 2006 and 2007 Notes (d)	–	–	102,431,160	24,303	24,303
Conversion of preferred shares into common shares (d)	4,600,000	1,187	(4,600,000)	(1,095)	92
Deferred tax liability on preferred shares (d)	–	–	–	(316)	(316)
Issued on exercise of Rights offering (c)	52,363,419	8,991	–	–	8,991
Balance December 31, 2009	110,439,105	$ 285,542	97,831,160	$ 22,892	$ 308,434

11. Share capital (continued):

(c) Common shares:

On September 10, 2009, the Company completed a CDN$9,687 (US$8,991) rights offering and issued a total of 52,363,419 common shares at a price of CDN$0.185 per share (the Subscription Price). Financing fees of $389 have been charged to the deficit. Under the rights offering, rights were exercised to subscribe for 9,120,177 common shares at the Subscription Price for proceeds of CDN$1,687. At the same time, in accordance with the terms of the stand-by purchase agreements entered into by BELLUS Health with the Investors, each of Vitus and VSVI subscribed for 21,621,621 common shares of BELLUS Health at the Subscription Price for an aggregate of CDN$8,000. The Subscription Price represented a 25% discount off the volume weighted average price of the Company's common shares on the TSX during the five (5) trading days immediately preceding the filing of the prospectus on July 15, 2009. The rights offering resulted in the reduction of the conversion price of the 2006 Notes to $16.03 and rendered such notes immediately convertible; resulted in the reduction of the conversion price of the 2009 Notes to CDN$0.185 and the reduction of the exercise price and increase in outstanding number of the warrants issued in connection with the 2007 Notes (refer to (h) for warrants).

(d) Preferred shares:

In connection with the 2009 Notes financing, and as a condition thereto, BELLUS Health and all of the existing noteholders agreed to amend the terms of the Original Notes. Holders of $29,085 principal amount of 2006 Notes and $4,000 principal amount of 2007 Notes agreed to amend the terms of their notes to make them convertible into preferred shares in the authorized capital of BELLUS Health and received 3,096 preferred shares per $1 aggregate principal amount of existing convertible notes, representing a conversion price equal to 200% of the Financing Conversion Price (resulting in a conversion price of CDN$0.40 per share) (the Preferred Share Conversion Price). A total of 102,431,160 preferred shares were issued to noteholders who elected to receive preferred shares. The preferred shares are convertible into common shares on a one-to-one basis at the option of the holder, subject to adjustment; entitle the holder to 6% cumulative dividends, payable in cash or common shares at the then market price at the option of the Company; and will automatically be converted into common shares in April 2014. In the event of a delisting of the Company's shares on the TSX, the accrued dividends on the preferred shares would be payable in cash.

11. Share capital (continued):

(d) Preferred shares (continued):

In accordance with Canadian GAAP, this conversion of the Original Notes into preferred shares was accounted for in two steps: firstly, as a repurchase of the Original Notes by the Company and, secondly, as an issuance of preferred shares from treasury. The Original Notes were initially accounted for as compound financial instruments with both debt and equity components. Accordingly, upon conversion, the difference between the fair value of the preferred shares and the book value of the Original Notes debt and equity components and related embedded derivatives, was accounted for partially as an extinguishment of the debt component with a gain on extinguishment of debt in the statement of operations in the amount of $10,777 (net of a $996 loss on settlement of the 2007 Original Notes embedded derivative asset), and partially as a capital transaction related to the repurchase of the equity component in the amount of $2,205, which was charged to the deficit. The fair value of preferred shares was determined based on the value of common shares at the date of issuance, as preferred shares are convertible into common shares on a one-to-one basis, and by discounting at a rate of 41.02% the cumulative dividend payments due at maturity. The preferred shares issued on conversion possess both liability and equity attributes and therefore were also accounted for as compound financial instruments with both a debt and an equity component; the debt component in the amount of $1,762, net of issue costs of $18, represents the present value of the future dividend stream, while the residual amount of the fair value of the preferred shares in the amount of $24,303 was allocated to the preferred shares. Related issue costs of $240 have been charged to the deficit. The debt component is classified in long-term liabilities on the consolidated balance sheet. The accretion of the debt component amounted to $479 during the year ended December 31, 2009.

The cumulative dividends of preferred shares give rise to Part VI.1 Tax on dividends paid to preferred shares holders not having more than a 25% share of voting rights in the Company. A deferred tax liability is recorded based on the book value of the liability portion of the preferred shares representing the present value of the potential dividends, using a rate of 41.02%, and accreted to the total dividends owing at April 2014. The deferred tax expense, amounting to $107 for the year ended December 31, 2009, is presented with the preferred share liability accretion expense. Upon conversion, a portion of the deferred tax liability is transferred to share capital.

During the year ended December 31, 2009, 4,600,000 preferred shares were converted into 4,600,000 common shares. Consequently, on conversion, the amounts of $1,095 and $92 were reclassified from preferred shares and long-term liabilities, respectively, to common shares.

11. Share capital (continued):

(e) Stock option plan:

Under its stock option plan, the Company may grant options to purchase common shares to employees, directors and consultants of the Company (the Stock Option Plan). The terms, number of common shares covered by each option, as well as the vesting period are determined by the Board of Directors. In general, options vest over periods of up to five years. The maximum number of shares reserved for issuance is equal to 12.5% of the issued and outstanding common shares. The maximum number of common shares which may be optioned in favor of any single individual shall not exceed 5% of the issued and outstanding common shares of the Company. The option price per share is equal to the weighted average trading price of common shares for the five days preceding the effective date of grant during which the common shares were traded on the TSX. In no event may the term of any option exceed ten years from the date of the grant of the option.

Changes in outstanding options issued under the Stock Option Plan for the years ended December 31, 2008 and 2009 were as follows:

	Number	Weighted average exercise price
		(CDN$)
Options outstanding, December 31, 2007	2,816,733	$ 16.75
Granted	3,143,600	1.46
Exercised	(11,500)	0.65
Cancelled	(1,299,825)	19.68
Options outstanding, December 31, 2008	4,649,008	5.63
Granted	825,000	0.22
Cancelled	(652,617)	10.13
Expired	(102,050)	3.38
Options outstanding, December 31, 2009	4,719,341	$ 4.11

11. Share capital (continued):

(e) Stock option plan (continued):

The following table summarizes information about options outstanding and exercisable at December 31, 2009:

	Options outstanding			Options exercisable	
Exercise price/share	Number	Weighted average exercise price	Weighted average years to expiration	Number	Weighted average exercise price
(CDN$)		(CDN$)			(CDN$)
$ 0.20 - $0.56	1,040,000	$ 0.29	10.4	43,000	$ 0.56
$ 1.50 - $2.07	2,710,600	1.53	8.2	542,120	1.53
$ 2.99 - $3.75	116,408	3.14	3.6	99,638	3.07
$ 6.79 - $6.93	123,000	6.86	5.0	85,800	6.83
$ 8.37 - $10.27	111,000	8.99	3.7	104,800	8.91
$13.48 - $15.35	120,500	15.23	6.3	73,800	15.20
$17.40 - $23.35	340,833	19.25	5.7	224,533	19.92
$25.30 - $32.25	157,000	27.68	4.8	137,000	28.03
	4,719,341	$ 4.11	7.8	1,310,691	$ 9.24

(f) Agreement to issue shares:

The agreement with Dr. Francesco Bellini, then Chief Executive Officer, effective December 1, 2004, to issue to him up to 220,000 common shares upon the execution of the agreement and upon achievement of specified performance targets, was approved by regulatory authorities and shareholders in 2005. As at December 31, 2009, stock-based compensation expense in relation to 140,000 of the total 220,000 common shares was previously recorded. The shares will be issued by the Company upon formal notification by Dr. Francesco Bellini. During the years ended December 31, 2009 and 2008, the Company did not record additional stock-based compensation in relation to common shares to be issued to Dr. Francesco Bellini in connection with his execution and achievement of certain specified targets.

(g) Deferred share unit plan:

The Company has various deferred share unit (DSU) plans for employees and members of the Board of Directors created to afford the Company the flexibility to offer DSUs as an alternative to cash compensation.

11. Share capital (continued):

(g) Deferred share unit plan (continued):

The price of DSUs is determined by the five-day volume weighted average trading price of the Company's common shares at the time the DSUs are issued, as provided for under the respective plans. The DSUs are redeemable only upon the participant's resignation, termination, retirement or death, in cash, at a value equal to the number of DSUs credited, multiplied by the 5-day market value weighted average price of common shares prior to the date on which a notice of redemption is filed.

For DSUs, compensation cost is measured based on the market price of the Company's common shares from the date of grant through to the settlement date. Any changes in the market value of the Company's common shares through to the settlement date result in a change to the measure of compensation cost for those awards and are recorded in the consolidated statement of operations.

Changes in the number of units for the years ended December 31, 2009 and 2008 were as follows:

Number of units	December 31, 2009	December 31, 2008
Balance, beginning of year	49,755	26,567
Units granted	6,458,654	23,188
Units paid	(214,576)	–
Balance, end of year	6,293,833	49,755
Balance, December 31	$ 1,082	$ 19

During the year ended December 31, 2009, the Company granted 6,458,654 DSUs (2008 - 23,188), having a weighted average fair value per unit of CDN$0.26 (2008 - CDN$2.07). The stock-based compensation recorded in the consolidated statements of operations for the years ended December 31, 2009 and 2008 is $1,054 and $(17), respectively. For the year ended December 31, 2009, 214,576 units were redeemed for $71. At December 31, 2009, the Company had a liability of $1,082 (2008 - $19) with respect to issued DSUs.

11. Share capital (continued):

(h) Warrants

As at December 31, 2009, in connection with the 2007 Notes (see note 10 (b)), warrants to purchase an aggregate of 13,589,602 common shares (2008 - 2,250,645) of the Company until May 2, 2012, at a purchase price of $2.10 per share (2008 - $12.68), are outstanding. The number and price of the warrants were adjusted as a result of the April 2009 financing.

12. Stock-based compensation:

For the year ended December 31, 2009, the Company recorded total stock-based compensation (excluding compensation under the DSU plans) of $1,247 (2008 - $2,325), related to stock options granted under the Stock Option Plan after July 1, 2002.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes pricing model. The weighted average assumptions for the years ended December 31, 2009 and 2008 were as follows:

	2009	2008
Risk-free interest rate	2.86%	3.25%
Expected volatility	91%	77%
Expected life in years	7	7
Expected dividend yield	nil	nil

The following table summarizes the weighted average grant-date fair value per share for options granted during the years ended December 31, 2009 and 2008:

	Number of options	Weighted average grant-date fair value
		(CDN$)
Year ended:		
December 31, 2009	825,000	$ 0.19
December 31, 2008	3,143,600	1.05

Dividend yield was excluded from the calculation, since it is the present policy of the Company to retain all earnings to finance operations and future growth.

13. Commitments and contingencies:

(a) Operating leases and other:

Minimum annual lease payments for the next four years and thereafter under operating leases are as follows, assuming the exercise of the First Termination Option in April 2011:

2010	$ 993
2011 (1)	10,155
2012	160
2013	16
	$ 11,324

(1) The company will have the option to settle $9,788 with the issuance of common shares (refer to note 8 (b) (i)).

In addition, the Company is responsible for operating costs and taxes under the operating leases.

(b) License agreements and research collaborations:

On February 1, 2006, the Company entered into an assignment agreement with Parteq Research and Development Innovations (Parteq) (the Assignment Agreement) which terminated an amyloid license agreement. This amyloid license agreement granted the Company an exclusive worldwide license under certain intellectual property (the Amyloid Intellectual Property). Pursuant to the Assignment Agreement, Parteq agreed and assigned the Amyloid Intellectual Property to the Company for consideration, comprising an upfront payment of CDN$200 and various deferred payment amounts, which are approximately equal to the payments provided for in the amyloid license agreement. The Assignment Agreement also provides for annual technology payments, deferred milestone payments and deferred graduated payments based on gross revenues to be generated from commercialized products, which approximate the payments included in the amyloid license agreement.

Under the terms of an agreement with the federal Ministry of Industry (Technology Partnerships Canada Program), as amended in 2005, the Company is committed to pay the federal government royalties equal to 7.24% of certain milestone revenue and 0.724% of end-product sales realized from the commercialization of effective orally-administered therapeutics for the treatment of Alzheimer's disease until December 31, 2010. After December 31, 2010, the Company may have to continue to pay royalties until such time as the aggregate amount of royalties paid pursuant to the agreement reaches CDN$20,540. Under the agreement, the Company is committed to spend a specified amount on research and development from the date of regulatory approval to December 31, 2014.

13. Commitments and contingencies (continued):

(b) License agreements and research collaborations (continued):

The Company outsources clinical trials in the normal course of business. As at December 31, 2009, the Company's future obligations, with respect to these clinical trial agreements, amount to $1,608 (2008 - $1,797).

(c) Consulting and services agreement:

The payments under the new consulting and services agreement with Picchio International Inc. (Picchio International), a company related to a shareholder and director (see note 14 (a)) will be of $239 in 2010, plus applicable expenses for services rendered under the agreement.

(d) Guarantees:

The Company is contingently liable for letters of credit in the amount of $975. An equivalent face value amount of the New ABCP Notes is pledged under these letters of credit and is presented as restricted cash on the consolidated balance sheet as at December 31, 2009. The balance of the New ABCP Notes is pledged under the credit facilities. The Company has not recorded a liability with respect to the guarantees, as the Company does not expect to make any payments for these items. The Company has determined that the fair value of the non-contingent obligations requiring performance under the guarantees in the event that specified events or conditions occur approximate the cost of obtaining the letters of credit.

14. Related party transactions:

(a) Under the terms of a management services agreement entered into in March 2003, as amended, with Picchio International, the Company recorded management fees of $1,568 for the year ended December 31, 2009 (2008 - $2,360). The management services agreement was amended in June 2009 whereby a portion of the management fee is settled in DSUs ($669 for the year ended December 31, 2009). These DSUs are included in note 11 (g), where the terms of these DSUs are described. The management services agreement with Picchio International expired on December 31, 2009, which corresponded with Dr. Francesco Bellini’s retirement as President and Chief Executive Officer previously announced at the annual general meeting of shareholders in June 2009. Dr. Francesco Bellini remains Chairman of the Board of Directors and will also provide ongoing advisory services to the Company under the terms of a new consulting and services agreement between the Company and Picchio International. The agreement has a one-year term and shall renew for successive one-year terms.

14. Related party transactions (continued):

(a) (continued):

In 2004, the Company entered into an agreement to issue shares to Dr. Francesco Bellini, then Chief Executive Officer. See note 11 (f).

(b) In July 2008, as disclosed in note 4, the Company acquired 100% of the remainder of the outstanding capital stock that it did not already own of Innodia.

These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

15. Income taxes:

(a) Details of the components of income taxes are as follows:

	Year ended December 31, 2009	Year ended December 31, 2008
Loss before income taxes:		
Canadian operations	$ 4,655	$ (21,238)
Foreign operations	(12,882)	(26,857)
	(8,227)	(48,095)
Basic income tax rate	30.9%	30.9%
Computed income tax recovery	(2,542)	(14,861)
Adjustments in income taxes resulting from:		
Non-recognition of losses and other deductions	5,025	2,456
Difference in tax rate of a foreign subsidiary	2,612	8,348
Non-deductible stock option expense	711	714
Permanent differences and other	(5,806)	3,343
	$ –	$ –

15. Income taxes (continued):

(b) Net future tax assets:

The future tax assets and liabilities at December 31, 2009 and 2008 are as follows:

	2009	2008
Future tax assets:		
Patent costs	$ 4,987	$ 9,005
Unclaimed scientific research and experimental development expenditures for tax purposes	25,065	21,697
Deferred gain on sale of property	1,890	4,278
Accrued liabilities	2,210	443
Share issue costs	825	738
Net operating losses	22,987	14,940
Other	235	376
	58,199	51,477
Less: valuation allowance	(57,540)	(50,684)
	659	793
Future tax liabilities:		
Equipment	(585)	(691)
Deferred financing fees	(74)	(66)
Notes	–	(36)
Net future tax assets	$ –	$ –

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income and/or tax planning strategies. Since the Company is a development stage enterprise, the generation of future taxable income is dependent on the successful commercialization of its products and technologies.

(c) The Company has the following unclaimed deductions available to reduce future taxable income in Canada:

	Federal	Quebec
Research expenditure pool (no expiry)	$ 116,227	$ 64,128

15. Income taxes (continued):

(c) (continued):

The Company also has approximately $20,416 in federal research investment tax credits that can be used to reduce future federal taxes payable and which expire as follows:

2020	$ 17
2021	160
2022	220
2023	412
2024	3,779
2025	4,400
2026	3,794
2027	4,052
2028	2,223
2029	1,359
	$ 20,416

(d) The Company has non-capital losses carried forward which are available to reduce future years' taxable income. These expire as follows:

	Canadian companies	Foreign subsidiaries
2011	$ –	$ 51,160
2012	1,605	56,470
2013	1,586	69,787
2014	–	97,993
2015	–	71,013
2016	–	41,478
2024	3,618	–
2025	3,258	–
2026	1,923	–
2027	6,580	–
2028	8,825	–
2029	9,182	–
	$ 36,577	$ 387,901

16. Basic and diluted loss per share:

The reconciliation between basic and diluted loss per share is as follows:

	Year ended December 31, 2009	Year ended December 31, 2008
Basic loss per share:		
Basic weighted average number of common shares outstanding	140,186,578	49,531,640
Basic net loss per share	$ (0.06)	$ (0.97)
Diluted loss per share:		
Net loss	$ (8,227)	$ (48,095)
Adjustments for dilutive impacts of 2006 and 2007 Original Notes	(15,522)	–
Net loss for calculation of diluted loss per share	$ (23,749)	$ (48,095)
Basic weighted average number of common shares outstanding	140,186,578	49,531,640
Plus dilutive impact of 2006 and 2007 Original Notes	847,806	–
Diluted weighted average number of common shares outstanding	141,034,384	49,531,640
Diluted net loss per share	$ (0.17)	$ (0.97)

As the preferred shares are automatically converted into common shares at maturity, if not before, they embody a right to the residual equity of the Company for which the only condition to issuance is the passage of time and, therefore, are included in the basic weighted average number of common shares outstanding. Also, included in the weighted average number of shares outstanding are 140,000 common shares to be issued to Dr. Francesco Bellini upon formal notification. See note 11 (f).

16. Basic and diluted loss per share (continued):

Excluded from the calculation of the diluted loss per share are the effects of stock options, 2009 Notes, Amended Notes, Deferred Rent promissory notes, warrants and cumulative dividends on preferred shares, as the effect would be anti-dilutive. All outstanding stock options, 2009 Notes, Amended Notes, Deferred Rent promissory notes, warrants and cumulative dividend on preferred shares could potentially be dilutive in the future.

17. Statements of cash flows - supplementary disclosure:

(a) Cash and cash equivalents:

Cash and cash equivalents consist of cash balances with banks and short-term investments:

	2009	2008
Cash balances with banks	$ 13,393	$ 6,096
Short-term investments (yielding interest at 0.45% to 0.80% as at December 31, 2008)	–	4,499
	$ 13,393	$ 10,595

(b) Interest and income taxes:

	Year ended December 31, 2009	Year ended December 31, 2008
Cash paid for:		
Interest	$ 184	$ 2,926
Income tax	–	–

Refer to note 4 for non-cash acquisition of Innodia Inc.

18. Segment disclosures:

(a) Business segment:

The Company operates in one business segment, the research, development and commercialization of products for health solutions. The Company's operations are conducted principally in Canada and Europe.

(b) Equipment by geographic area is as follows:

	2009	2008
North America	$ 2,440	$ 3,054
Europe	39	70
	$ 2,479	$ 3,124

(c) Major customers:

As referred to in note 5, the collaboration agreement ended in 2008. All revenues recognized in 2008 under the collaboration agreement were derived from one customer. There were two customers that each accounted for more than 10% of gross sales in 2009 (four in 2008).

19. Capital disclosures:

The Company's objective in managing capital is to ensure a sufficient liquidity position to market its technologies and product candidates, to finance its research and development activities, general and administrative expenses, working capital and overall capital expenditures, including those associated with patents.

Since inception, the Company has financed its liquidity needs primarily through public offerings of common shares, private placements, issuance of convertible notes as well as a sale-leaseback transaction. When possible, the Company tries to optimize its liquidity needs by non-dilutive sources, including research tax credits, grants, interest income, as well as with proceeds from the collaboration and research agreements.

The Company defines capital to include total shareholders' deficiency (excluding accumulated other comprehensive income) and notes.

As at December 31, 2009, the Company had convertible and promissory notes in the amount of $16,577, with an aggregate face value of $35,138.

The capital management objectives remain the same as for the previous fiscal year.

19. Capital disclosures (continued):

As at December 31, 2009, cash and cash equivalents amounted to $13,393 and accounts receivable and other and research tax credits receivable amounted to $3,819, for a total of $17,212. The Company requires continued access to capital markets to support its operations, as well as to achieve its strategic plans. Any impediments to the Company's ability to continue to meet the conditions contained in its credit facilities and convertible notes as well as the Company's ability to access capital markets, including the lack of financing capability or an adverse perception in capital markets of the Company's financial condition or prospects, could have a materially adverse effect on the Company. In addition, the Company's access to financing is influenced by the economic and credit market environment. See note 1(a).

The Company's general policy on dividends is to retain cash to keep funds available to finance the Company's growth.

The Company is not subject to any capital requirements that are externally imposed.

20. Financial instruments:

(a) Financial instruments - carrying values and fair values:

Fair value estimates are made as of a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and may not be determined with precision.

The Company has determined that the carrying value of its short-term financial assets (excluding research tax credits receivable) and liabilities approximates their fair value because of the relatively short periods to maturity of these instruments. Refer to note 6 for investment in New ABCP Notes and restricted cash. The carrying value of the financial liabilities included in long-term liabilities also approximates fair value. The fair value of convertible notes is estimated based on discounting expected future cash flows at the discount rates which represent borrowing rates presently available to the Company for instruments with similar terms and maturity.

The fair values of the convertible notes were as follows:

	December 31, 2009		December 31, 2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Notes	$ 16,577	$ 16,866	$ 37,464	$ 17,213

20. Financial instruments (continued):

(b) Credit risk:

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, accounts receivable, restricted cash and investment in New ABCP Notes. The Company invests cash with major North American and European financial institutions. Cash equivalents are comprised of fixed income instruments with a high credit ranking (not less than A-1) as rated by Standard and Poor's. The Company has investment policies that are designed to provide for the safety and preservation of principal, the Company's liquidity needs and yields that are appropriate.

The Company's exposure to credit risk related to accounts receivable is minimized through a customer base predominantly comprised of well established retailers and wholesalers, a program of credit evaluation of new customers and limits on the amount of credit extended as deemed necessary. The Company performs continuous evaluation of its accounts receivable and records an allowance for doubtful accounts, if necessary.

As at December 31, 2009, the Company's maximum credit exposure corresponded to the carrying amount of these financial assets.

Refer to note 6 for credit risk related to investment in New ABCP Notes and restricted cash.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure, as outlined in note 19. It also manages liquidity risk by continuously monitoring actual and projected cash flows. The Board of Directors reviews and approves the Company's operating and capital budgets, as well as any material transactions out of the ordinary course of business.

Refer to notes 1 (a) and 19 with respect to material uncertainty in regards to the Company's liquidity.

20. Financial instruments (continued):

(c) Liquidity risk (continued):

The following are the contractual maturities of financial liabilities as at December 31, 2009:

	Carrying amount	Contractual cash flows	Less than 1 year	2 to 3 years	Greater than 3 years
Credit facilities	$ 10,284	$ 11,721	$ –	$ –	$ 11,721
Accounts payable and accrued liabilities	4,459	4,459	4,459	–	–
Financial liabilities included in long-term liabilities (1)	2,271	9,180	–	–	9,180
Notes (2)	16,577	60,891	810	5,674	54,407
	$ 33,591	$ 86,251	$ 5,269	$ 5,674	$ 75,308

(1) Assuming payment of dividends on preferred shares in April 2014. The Company has the option to settle the dividends with the issuance of common shares.

(2) Assuming redemption of Amended Notes in January 2014, redemption of 2009 Notes in April 2014 and repayment of Deferred Rent promissory notes in April 2011.

(d) Foreign currency risk management:

A portion of the Company's expenses are denominated in currencies other than the US dollar, primarily in Canadian dollars. This results in financial risk due to fluctuations in the value of the US dollar relative to these currencies. The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results.

20. Financial instruments (continued):

(d) Foreign currency risk management (continued):

The following table provides an indication of the Company's significant foreign exchange currency exposures as at December 31, 2009:

(in US dollars)					December 31, 2009
	$CDN	CHF	EURO	SEK	GBP
Cash and cash equivalents	12,850	34	85	–	–
Accounts receivable and other	305	17	37	–	–
Research tax credit receivable	3,457	–	–	–	–
Investment New ABCP Notes	3,615	–	–	–	–
Restricted cash	673	–	–	–	–
Accounts payable and accrued liabilities	(2,670)	(231)	(643)	(246)	(8)
Credit facilities	(6,200)	–	–	–	–
Long-term liabilities	(2,149)	–	(122)	–	–
Notes	(10,755)	–	–	–	–
	(874)	(180)	(643)	(246)	(8)

The following exchange rates applied during the year ended December 31, 2009:

	Average rate	Reporting date rate
$CDN per $US	1.1414	1.0466
CHF per $US	1.0860	1.0355
EURO per $US	0.7196	0.6977
SEK per $US	7.6524	7.1538
GBP per $US	0.6410	0.6186

20. Financial instruments (continued):

(d) Foreign currency risk management (continued):

Based on the Company's foreign currency exposures noted above, varying the above foreign exchange rates to reflect a ten percent strengthening of the US dollar would have decreased the net loss as follows, assuming that all other variables remained constant:

	$CDN	CHF	EURO	SEK	GBP
Decrease in net loss	88	18	64	25	1

An assumed ten percent weakening of the US dollar would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Effective January 1, 2010, the Company will adopt the Canadian dollar as its functional and reporting currency (note 1 (c)). The change in functional currency results in a foreign exchange risk exposure to $US balances at December 31, 2009, amounting to net $7,113, mainly due to the 2006 and 2007 Amended Notes, the credit facilities and the investment in New ABCP Notes.

(e) Interest rate risk:

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates.

The Company's exposure to interest rate risk is as follows:

Cash and cash equivalents	Short-term fixed interest rate
Investment in New ABCP Notes	Short-term fixed interest rate
Restricted cash	Short-term fixed interest rate
Credit facilities	Short-term variable interest rate
Notes	Fixed interest rate

Based on the value of variable interest-bearing amount during the year ended December 31, 2009, an assumed 1% increase or 1% decrease in interest rates during such period would have had no significant effect on the net loss.

The risk that the Company will realize a loss as a result of the decline in the fair value of its cash equivalents is limited because these investments, although available for sale, have short-term maturities and are generally held to maturity.

20. Financial instruments (continued):

(e) Interest rate risk (continued):

The capacity of the Company to reinvest the short-term amounts with equivalent returns will be impacted by variations in short-term fixed interest rates available in the market.

Interest income presented in the consolidated statements of operations represents interest income on available-for-sale financial assets.

21. Subsequent events:

(a) On January 11, 2010, 2,000,000 options were granted to the new President and Chief Executive Officer. Refer to note 11 (e) for terms of the Stock Option Plan.

(b) In January 2010, the National Association of Pharmacy Regulatory Authorities (NAPRA) issued a directive to provincial pharmacists associations requesting that pharmacists not sell natural health products that have not been issued a Natural Health Product Number (NPN) by Health Canada. The Company has taken a decision to temporarily cease its sales and marketing activities for the product until the NPN number has been received, expected in the middle of 2010. The Company plans on re-launching the product in Canada at that time. In the meantime, the product will still be available via the Internet. This decision does not have a significant impact on the consolidated financial statements.

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Shareholder information

Executive management

Dr. Francesco Bellini
Chairman President
and Chief Executive Officer

Dr. Denis Garceau
Senior Vice President,
Drug Development

Mr. François Desjardins
Vice President,
Finance

Dr. Nigel Levens
Vice President,
Research

Mr. David Skinner
Vice President,
General Counsel and Corporate Secretary

Mr. Roberto Bellini (1)
Vice President,
Business Development

(1) *Mr. Roberto Bellini had been named President and Chief Executive Officer of the Company, effective January 1, 2010.*

OVOS Natural Health Inc.
Mr. Gary Schmid
President and Chief Executive Officer

Board of Directors

Dr. Francesco Bellini
Chairman of the Board
BELLUS Health Inc.

Mr. Charles Cavell
Deputy Chairman,
Consultant

Mr. Roberto Bellini (1)
Vice President, Business Development
BELLUS Health Inc.

Mr. Neil Flanzraich
Consultant

Ms. Hélène Fortin
Partner
Demers Beaulne, GPCA

Mr. Pierre Larochelle
Vice President, Investments
Power Corporation of Canada

Mr. Joseph Rus
Executive Vice President,
Alliance Management & New
Market Development Shire
Pharmaceuticals Group

Corporate Governance

BELLUS Health is committed to sound corporate governance practices, which ensure that its affairs are managed in the best interest of all stakeholders. The Board of Directors undertakes a periodic review to verify that BELLUS Health's governance practices have kept pace with changing regulatory environments in Canada, to which BELLUS Health is subject as a company listed on the TSX. Please refer to the management proxy circular for more information on the overall structure of the Board and its Committees and for details of BELLUS Health's corporate governance practices.

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Stock Listing

Toronto Stock Exchange (TSX)
Symbol: BLU

Annual General Meeting

The Annual General Meeting of shareholders will be held at 10:00 am on May 12, 2010, in the Maxwell-Cummings Auditorium of the Michal and Renata Hornstein Pavilion of the Montreal Museum of Fine Arts, 1379, Sherbrooke Street West, Montreal, Quebec, Canada.

Certain statements contained in this document, other than statements of fact that are independently verifiable at the date hereof, may constitute forward-looking statements. Such statements, based as they are on the current expectations of management, inherently involve numerous risks and uncertainties, known and unknown, many of which are beyond BELLUS Health Inc.'s control. Such risks include but are not limited to: the ability to obtain financing immediately in the current markets, the impact of general economic conditions, general conditions in the pharmaceutical and/or nutraceutical industry, changes in the regulatory environment in the jurisdictions in which the BELLUS Health Group does business, stock market volatility, fluctuations in costs, changes to the competitive environment due to consolidation, that actual results may vary once the final and quality-controlled verification of data and analyses has been completed, as well as other risks disclosed in public filings of BELLUS Health Inc. Consequently, actual future results may differ materially from the anticipated results expressed in the forward-looking statements. The reader should not place undue reliance, if any, on any forward-looking statements included in this document. These statements speak only as of the date made and BELLUS Health Inc. is under no obligation and disavows any intention to update or revise such statements as a result of any event, circumstances or otherwise, unless required by applicable legislation or regulation. Please see the Annual Information Form as well as registration statements and other public filings of BELLUS Health Inc. for further risk factors that might affect the BELLUS Health Group and its business.